United States Court of Appeals

for the Second Circuit

BRIEF FOR APPELLANT

77-7125 77-7126

United States Court of Appeals
For the Second Circuit

B

P/S

DOROTHY L. COLE, LOIS H. ZISOOK, HARRY W. VOEGE, and ANNA MAY TUNMORE, as Trustees, SAMUEL GREENFIELD FUND, INC. and HAROLD STILLER and MILDRED STILLER, as joint tenants,

Plaintiffs,

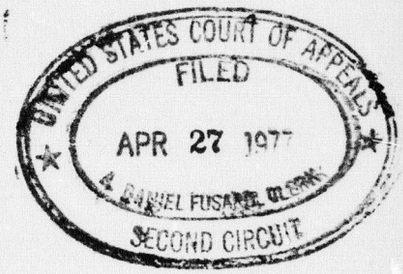
DOROTHY L. COLE, HARRY W. VOEGE, and ANNA MAY TUNMORE, as Trustees, and HAROLD STILLER and MILDRED STILLER, as joint tenants,

Plaintiffs-Appellants,

v.

SCHENLEY INDUSTRIES, INC., GLEN ALDEN CORPORATION, RAPID-AMERICAN CORPORATION, ISIDORE A. BECKER, BERNARD GOLDBERG, PAUL A. JOHNSTON, DAVID A. CHERNOW, WALTER O. HEINZE, HOWARD FELDMAN, MILO B. HOPKINS, RUSSELL G. SMITH, ALBERT N. GREENFIELD, MESHULAM RIKLIS, GLEN ALDEN SUBSIDIARY, INC., P.J. CLIFFORD, W.P. JOHNSON, S. KITTAY, M.L. MENDELL, L.C. LANE, G.H. PERKINS and B. DENMARK,

Defendants-Appellees.



ON APPEAL FROM A JUDGMENT OF THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK

BRIEF OF PLAINTIFF-APPELLANT DOROTHY L. COLE

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UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

Docket No. 77-7125
77-7126

DOROTHY L. COLE, LOIS H. ZISOOK, HARRY W. VOEGE and ANNA MAY TUNMORE, as Trustees, SAMUEL GREENFIELD FUND, INC., and HAROLD STILLER and MILDRED STILLER, as joint tenants.,

Plaintiffs,

DOROTHY L. COLE, HARRY VOEGE and ANNA MAY TUNMORE, as Trustees, and HAROLD STILLER and MILDRED STILLER, as joint tenants,

Plaintiffs-Appellants,

-against-

SCHENLEY INDUSTRIES, INC., GLEN ALDEN CORPORATION, RAPID-AMERICAN CORPORATION, ISIDORE A. BECKER, BERNARD GOLDBERG, PAUL A. JOHNSTON, DAVID A. CHERNOW, WALTER O. HEINZE, HOWARD FELDMAN, MILO B. HOPKINS, RUSSELL G. SMITH, ALBERT N. GREENFIELD, MESHULAM RIKLIS, GLEN ALDEN SUBSIDIARY, INC., P. J. CLIFFORD, W.P. JOHNSON, S. KITTAY, M. L. MENDELL, L.C. LAND, G. H. PERKINS and B. DENMARK,

Defendants-Appellees.

BRIEF OF PLAINTIFF-APPELLANT
DOROTHY L. COLE

PRELIMINARY STATEMENT

Plaintiff appeals from a final judgment of the United States District Court, Southern District of New York, (Richard Owen, D.J.) dated February 3, 1977, dismissing the complaint after a trial on the issue of liability in this class action. The complaint challenged the merger on June 17, 1971 of Schenley Industries, Inc. (Schenley), a subsidiary of Glen Alden Corporation (Glen Alden), with a 100% owned subsidiary of Glen Alden on the ground that the proxy statement describing the merger contained mis-statements and omitted material facts and on the further ground that the directors and controlling stockholder of Schenley violated their fiduciary obligations in consummating a grossly unfair merger.

ISSUES PRESENTED FOR REVIEW

1. Did the Court below err in excluding evidence and in finding that the proxy statement dated May 21, 1971 (the "Proxy Statement"), describing the merger, adequately disclosed the material facts about the value of Schenley stock and did not violate §§ 10(b) and 14(a) of the Securities Exchange Act of 1934 and Rules 10b-5 and 14a-9 thereunder?

2. Did the Court below err in refusing to hear evidence on and dismissing the common law claims that the directors of Schenley and Glen Alden disregarded their fiduciary obligations to the minority shareholders?

STATEMENT OF THE CASE

The Parties

The plaintiff-appellant and members of the class are former holders of approximately 1,100,000 shares of common and 2,520,000 shares of $1.40 convertible preferred stock ("Preferred") of defendant Schenley, a well known company in the alcoholic beverage business (A 950). Before the June 17, 1971 merger, defendant Glen Alden, a conglomerate, owned approximately 86% of the common stock of Schenley, giving it 84% of the voting power and 68% of the equity on a fully diluted basis - i.e.,if all the convertible preferred were converted. Defendant Rapid American Corporation (Rapid), in turn, owned 63% of the common stock of Glen Alden. The ten other defendants are officers and directors of the defendant corporations. (U.F. 2,3)*

The Nature of the Case

The public holders of common stock of Schenley were forced out of that enterprise at a price equivalent to not more than $29 per share, by merger of Schenley into a newly created subsidiary of Glen Alden.** Three years earlier, Glen Alden had acquired, by private purchase and public tender offer, 86% of Schenley's common stock at an average price of $58.80 per share.(U.F.2)

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* U.F. is an abbreviation for numbered, undisputed facts, to which the parties agreed in a pre-trial order, which are found in the Appendix ("A"), pages 110 to 110.23.

** The Preferred, which was convertible into 9/10 of a share of common at the holder's option, also forced out in the merger, received a price equivalent to not more than $26.10 per share, or 9/10 of the value of the package forced upon the common in the merger.(U.F.6)

The effect, if not the sole purpose of the 1971 merger, was to give the public shareholders of Schenley less than two thirds of the value they were entitled to receive for their shares and to give to Glen Alden $174 million of Schenley's liquid assets (cash or its equivalent).* In the words of defendant Meshulam Riklis, the head of the Rapid American empire, reflecting in March of 1971 on Glen Alden's 1968 acquisition of Schenley and Schenley's future:

> "Schenley had big assets--inventories and so on that could be converted into...When we started out, Schenley was $160,000,000 into the banks and had $30,000,000 in cash. Three years later, Schenley has got maybe $80,000,000 in cash and it's into the banks for $100,000,000. That's a $60,000,000 reduction in the line, and a $50,000,000 increase in the cash - $110 million difference in cash already. With the sale of Schenley's Buckingham subsidiary [under a Federal Trade Commission order], it'll be a $230,000,000 difference. Next year, without Buckingham, Schenley will make as much as it made with Buckingham three years ago, and I'll be sitting with $200,000,000 in cash. That's what I saw in Schenley-the great possibility of its being a huge cash generator, generating more cash than I put into it." (Quote from Forbes Magazine dated March 15, 1971, whose accuracy Riklis acknowledged, A. 235)

The capture for Glen Alden of almost the entire improvement in Schenley's position between 1968 and 1971, including approximately $140 million of surplus cash, i.e. liquid assets not needed for the operation of Schenley's business, and the refusal to share it with Schenley's minority stockholders - or to let them know of its magnitude - are at the core of this lawsuit. Unlike Riklis' statement above, which concisely stated the basic facts of Schenley's improvement and its accumulation of a large

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* $17 million of Schenley's cash together with a new issue of Glen Alden debentures was given to the public shareholders in the merger.

pool of surplus cash, the Proxy Statement omitted and obfuscated these and other facts which bore directly on the value of the minority's shares. Moreover, in fixing $29 per common share as the price to be paid to the minority shareholders, the defendants understated the value of Schenley's earnings and assets, and in particular, completely ignored the value of Schenley's surplus cash, so that by the forced merger, Glen Alden and Schenley's directors violated their fiduciary duties at common law.

Proceedings Below

After a seven day trial to the Court ending on October 30, 1975, the Court handed down its opinion constituting its findings of fact and conclusion of law, dated November 23, 1976, a copy of which is appended to this brief.

In its opinion, the Court below rejected plaintiffs' claim of mis-statements and omissions of material facts in the Proxy Statement. It found that the source and amount of the improvement in Schenley's position "was fully revealed" and that there was adequate disclosure of the amount of cash that was surplus to Schenley's needs and would be transferred to Glen Alden. There was "no question", the Court said, that a reader of the Proxy Statement "knew" the amount of cash which Schenley would transfer to Glen Alden for the latter's exclusive use, because the Proxy Statement informed him that the Glen Alden "debentures would be purchased for issuance to minority shareholders" (Op., p.7) and there was no need to denominate and state the amount of

Schenley's surplus liquid assets, i.e. those not needed to operate its business, because the facts from which such conclusions could be drawn were disclosed. (Op., p. 9)

In its opinon, the court below did not discuss the basis for dismissing the common law claims that the terms of the merger were grossly unfair. That claim was dismissed on the second day of trial on the ground that the fairness of the merger terms had been fully litigated and established in earlier suits denying injunctive relief and a statutory appraisal proceeding where a Delaware Court found the minority shares were worth 17% more than was given in the merger.

Plaintiffs submit that a review of the record and the precedents must lead this Court to the conclusion that the court below erred in deciding that defendants had complied with the disclosure requirements and anti-fraud provisions of the federal securities laws and in excluding or ignoring evidence relating to the higher value of the Schenley shares, and in rejecting the common law claims.

Statement of Facts

A. Glen Alden's Acquisition and Operation of Schenley

Glen Alden negotiated with Lewis Rosensteil, Schenley's founder, dominant stockholder and chief executive officer, for purchase of his 18% block of Schenley common stock, from early 1965 until March, 1968, when it succeeded in effecting the purchase for $75.6 million in cash or $53.33 per share*. (A 188)

*The price actually paid was $80 per share but the stock was split 3 for 2 so that $53.33 was the price per share of the new shares.

In connection with the March purchase from the Rosensteil interests, Glen Alden made a tender offer for the entire balance of the Schenley common stock for a package consisting of cash and Glen Alden debentures worth in the aggregate approximately $60 per share of Schenley stock. Approximately 5,300,000 of the remaining 6,300,000 Schenley common shares were tendered. In all, by August 1968, Glen Alden had acquired 86% of Schenley common stock at an average price of $58.80 per share.(U.F.2)

Glen Alden was willing to pay substantially more than the prevailing market prices which in 1967 and January and February 1968 ranged between 20 1/2 and 46 1/4 (A 1195) because, as Riklis stated, he saw in Schenley "the great possibility of its being a huge cash generator." (A 235) Glen Alden and Rapid American had consulted two financial advisers in connection with evaluating the initial decision to acquire control of Schenley.

Richard Graham, Riklis' assistant, and a vice president of Rapid, prepared a report for Glen Alden in February, 1967, in connection with the negotiations for purchase of the Rosensteil block.(U.F.15) Riklis referred to the Graham Report during the negotiations with Rosensteil. (A 198 et seq.). The Graham Report concluded that Schenley had such potential for generating cash that it was necessary to consider Schenley as two separate companies: one, a distilling company, and the other, a "bank".

The "bank" was in the form of excess assets consisting of (a) inventory, (b) accounts receivable, and (c) a contemplated sale of a 52% stock interest in Buckingham Corporation. These three categories of assets could be converted into at least $205 million in cash in a period of 4 to 8 years. According to Graham, on a pre-stock split basis, the "bank" alone had a then discounted value of $165 million or a worth of $33 per share of Schenley common and the capitalized earnings, using a multiplier of 15, were worth $35 per share, a total of $68. (A 1306-7)

The excess or surplus character of the cash expected from Schenley was understood clearly by Glen Alden. Indeed, its existence was perceived as essential to the acquisition, because without the cash to be generated by Schenley, Glen Alden would not have "any current or projected cash flow available for the Schenley transaction. In other words, Schenley's cash flow from its bank/operations must be utilized to carry and repay all obligations incurred by us in its acquisition." (A 1308)

Graham believed that Glen Alden could "pay as much as $75 - $80 per share for Schenley" or $50.00 - $53.33 after the three-for-two stock split (A 1308) for the Schenley common stock owned by the Rosensteil Group.* Glen Alden paid precisely $53.33 per share for the Rosensteil shares in March of 1968. (U.F.2)

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* Graham believed that Glen Alden could improve the profitability of Schenley by more than enough to justify the price.

Glen Alden received similar advice from "outside" bankers. In 1968, in resisting the effort by Glen Alden stockholders to enjoin the tender offer for Schenley (in an action in New York Supreme Court entitled Sanders v. Riklis) on the ground that Glen Alden was paying too much for Schenley, Glen Alden hired the investment banking firm of Bear, Stearns & Co., Inc. (U.F. 17) to explain its decision to pay a price so much higher than appeared justifiable by Schenley's book value, its market price, or its past earnings. In an affidavit submitted in the litigation, Bear, Stearns noted that the price which Glen Alden would pay in the tender offer capitalized Schenley's earnings at approximately 20 times, a multiple which appeared to be too high. But because Schenley had excess assets which could be converted into cash and would be available to Glen Alden, Glen Alden's effective purchase price would be reduced by roughly 40%. "As a result, the effective purchase price, after realization of excess current assets, would become only about 12 times earnings."* (A 1320)

---

* That affidavit stated among other things, that Schenley had excess assets that could be converted into $170 million in cash.

> "...in our judgment there is a special factor in the Schenley situation that warrants the payment of a higher than ordinary multiple [of earnings]. Schenley's working capital (consisting of liquid assets, receivables and inventory less current liabilities) appears to be substantially in excess of its requirements. Attached hereto as Exhibit J is a table setting forth the relevant current asset statistics of the major liquor companies and Schenley's excess is readily apparent therein.
>
> To bring its inventories into line with the level prevailing in the industry, Schenley could, over a period of four to seven years, reduce its inventories of spirits by about 40%, i.e. about $120 million. Similarly, if receivables could be reduced by $20 million and liquid assets could be reduced by $30 million without any material effect upon earning power, the combined effect of these items would be to reduce the effective cost of the purchase of Schenley by 40%." (A 1320)

(1) Schenley Generated Surplus Cash While Increasing Earnings

The exchange offer was consummated on August 30, 1968. Thereafter, as Glen Alden had expected and planned, Schenley substantially increased its earnings while converting superfluous assets into surplus cash.

In its May 31, 1968 balance sheet, Schenley (excluding Buckingham) had $13.5 million in cash, and on its May 31, 1971 balance sheet, Schenley had $191.1 million of cash.* On May 31, 1968 Schenley's current liabilities were $184 million (excluding Buckingham) and on May 31, 1971 they were down to $169 million. (A 1255; 1265; 1402; 1435) In three years, Schenley experienced an increase of $177.7 million in cash and a $37.9 million reduction of long and short term indebtedness, a total improvement of $215.6 million.

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* The term "cash" includes, cash, certificates of deposit, marketable securities and the like.

The bases for this improvement were substantially as follows:

1.	$32 million	Buckingham's marketable securities*
2.	$29.4 million	Reduction in inventory°
3.	$23.5 million	Reduction in accounts receivables°
4.	$14 million	Sale of Schenley's domestic wine business (U.F. 21)
5.	$90 million	1971 sale of Buckingham**
6.	$27 million	Increase in retained earnings from May 31, 1968 to May 31, 1971.***

---

* When Glen Alden acquired Schenley in 1968, Schenley owned 52% of the outstanding stock of the Buckingham Corporation, which distributed Cutty Sark Scotch in the United States. At 6/30/69 Buckingham had $32.7 million in marketable securities (A 1100) which it did not need in the operation of its business, but which were not available to Schenley so long as Buckingham had minority stockholders (A 1078-9). In December 1969 Schenley acquired those liquid assets for itself by merging Buckingham into itself in a transaction which forced the Buckingham minority shareholders to accept the new Schenley Preferred (A 1075), the same stock that is being forced out in the merger here challenged (U.F. 19).

° Schenley's total inventory at May 31, 1968 (excluding Buckingham's inventory of $9 million), was $324.3 million and by May 31, 1971 had decreased to $294.9 million, a reduction of $29.4 million. Schenley's accounts receivable, excluding Buckingham's of $4.3 million, at May 31, 1968, were $134.4 million. By May 31, 1971, they were $110.0 million, a reduction of $23.5 million. (A 1255; 1257; 1402)

** In October 1970, under the lash of the anti-trust laws which precluded Schenley from being a distributor of both Dewars and Cutty Sark brands of scotch whiskey, Schenley entered into an agreement to sell its 100% stock interest in Buckingham for $120 million. The sale, scheduled for closing on December 31, 1970, was postponed several times and was consummated on May 10, 1971. (A 991)

*** After eliminating $71.3 million gain from the Buckingham sale and $11.9 million of "pooling of interests" which had no cash flow effect. (A 1255, 1257, 1402, 1041).

As Riklis told Forbes magazine in March 1971, even with this tremendous improvement in its cash position, "Next year, without Buckingham, Schenley will make as much as it made with Buckingham three years ago..." (A 234-35). Schenley's earnings from 1968 through 1972 were as follows*:

	Year Ended				
	December 31, 1972	December 31, 1971	December 31, 1970	December 31, 1969	August 31, 1968
Revenues:					
Net sales	$693,143,000	$637,658,000	$615,494,000	$585,856,000	$493,953,000
Other income — net	4,180,000	4,262,000	1,982,000	2,341,000	1,268,000
	697,323,000	641,920,000	617,476,000	588,197,000	495,221,000
Costs and Expenses:					
Cost of goods sold	555,215,000	511,502,000	492,931,000	471,078,000	391,645,000
Selling, advertising and administrative expenses	87,167,000	80,654,000	76,631,000	71,762,000	70,876,000
Interest expense — net	6,415,000	8,945,000	13,120,000	14,922,000	12,866,000
Provision for Federal taxes on income	21,880,000	18,530,000	16,321,000	14,857,000	8,008,000
	670,677,000	619,631,000	599,003,000	572,619,000	483,395,000
Income from Continuing Operations	26,646,000	22,289,000	18,473,000	15,578,000	11,826,000
Income from The Buckingham Corporation	—	2,723,000	8,710,000	9,685,000	9,190,000
Income before Extraordinary Items	26,646,000	25,012,000	27,183,000	25,263,000	21,016,000
Extraordinary Items	—	60,024,000	—	—	—
Net Income	$ 26,646,000	$ 85,036,000	$ 27,183,000	$ 25,263,000	$ 21,016,000

* The above chart, taken from the 1972 Annual Report of Schenley , was excluded by the trial court on the ground that post-merger date results were not relevant to pre-merger date facts. (A 1397)

(2) Management's Assessment of Schenley's Progress

(a) From the time it acquired control of Schenley, the management of Glen Alden, when called upon to express or defend its opinion as to the value of its Schenley shares, consistently has taken the position that its Schenley shares have not declined in value since acquisition. Glen Alden reflected its cost of 6,887,089 Schenley common shares that were purchased in 1968 ($404,239,065, or $58.65 per share) [U.F.21] on its books as of August 31, 1968 by allocating $268,656,047 or $38.95 per share to its 86% stock interest in the net assets of Schenley, as shown in the latter's balance sheet. The balance of the cost, $135,583,212 or $19.70 per share, reflected the excess of cost over its equity in those net assets which Glen Alden allocated to intangibles of $85,583,212 and franchises of $50,000,000 (U.F.37) The "franchise" value was attributed to Schenley's exclusive right to distribute Dewar's White Label Scotch under a three year contract expiring in April 1973 which had been renewed from time to time since 1936. (A 994) By December 31, 1970, the equity in net assets increased to $43.02 per share because of interim undistributed profits, and the $19.70 per share for the intangibles and franchises remained unchanged for a total of $62.72 per share.

A note to its audited financial statements for the calender years 1968, 1969 and 1970, written by the management of

Glen Alden, stated that there had been no diminution in the value of its investment in Schenley since acquisition and, for that reason, while other intangibles were being amortized, those attributable to Schenley were not being amortized. That opinion of Glen Alden's management is not found or mentioned in the body of the 66-page Proxy Statement. It is found at the end of the Proxy Statement in a note to the 1969 and 1970 balance sheets of Glen Alden as certified by Haskins & Sells (who were also auditors of Schenley) (A1028)* A similar note is found in the December 31, 1971 Glen Alden balance sheet. (A 1420) The accountant supervising the audit testified at trial that the management of Glen Alden prepared the note and that Haskins & Sells reviewed the not by "looking at many things to indicate whether there

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*"D. Intangibles and Franchises

Intangibles represent the excess of unallocated cost of investments over equity in net assets of Schenley ($85,583,212) and other subsidiaries (1969, $34,198,763; 1970, $43,044,738. These net excess acquisition costs have been recognized by the management of Glen Alden as being similar in nature to intangibles which have not declined in value since acquisition. Accordingly, at the respective dates of acquisition, the management of Glen Alden adopted the policy of not amortizing these excess purchase costs so long as there is no diminution in value of the related investments.

Other intangibles are being amortized over periods not exceeding twenty years.

Franchises [of $50,000,000] consist of Schenley contracts to import whiskeys, liquors, and other distilled spirits which, in the opinion of management, have continuing value and accordingly are not being amortized." (U.F. 33; A 1028)

was any permanent diminution in value or impairment in value" (A 591-2)* in the stated cost of the investment in Schenley, including past earnings of the company, the balance sheet and the amount of its liquid assets (A 596-7) and saw "nothing that would indicate that there was any indication of permanent impairment at that point." (A 597) The December 31, 1971 Glen Alden audited statement expressed the same opinion that there was no diminution in the value of the investment in Schenley. (A 609-10)

(b) Glen Alden's opinion of the value of Schenley is also reflected in its presentation to the Referee appointed to report on the fairness of the settlement proposed in Sanders v. Riklis, supra, p. 8 , during which counsel for Rapid and Riklis stated:

> "Mr. LEVIN: I think the annual statements of the respective companies would bear out what I am going to say: that what was contended to be proper and prudent business judgment in 1968 with respect to the future of the respective companies acquired and the amounts paid for these companies, history has proven this judgment to be correct.
>
> As a matter of fact, Schenley ... to the extent to which this complaint attacks that acquisition, have proven to be very prudent and providential and wise acquisitions.
>
> I would ask that Mr. Jones [plaintiff's counsel], in a presentation of his document, offer to the Referee the subsequent annual statements of both Schenley and Stanley Warner, which I think would eliminate any question whatsoever as to the wisdom of the business judgement that was entered." (A 1413-14)

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* In accordance with the requirements of the then applicable Accounting Research Bulletin, No. 43, Ch. 5 (A 624). That Bulletin is found at A 945 et seq.

(c) Before the end of 1970 it became apparent to the management of Glen Alden that its 1968 expectations that Schenley could generate $170 million in cash from its assets without reducing earnings would be more than fulfilled within the coming year. That expectation and fulfillment were dramatically and succinctly summarized by Meshulam Riklis in the remarks in the Forbes' magazine article set forth at page 3 above. Schenley substantially increased its level of earnings, while converting superfluous assets into surplus cash between 1968-1971.

3. The Surplus Character of Schenley's Cash

At May 31, 1971 Schenley had on hand $50.8 million in cash, $124.5 million in marketable securities and $15.8 million of Glen Alden 6% Debentures at cost. (A 1402) How much of the total of $191.1 million was surplus to its needs?

Appellees did not, and cannot, contend that the $98.1 million in cash that was to be taken out of Schenley's treasury for the merger did not constitute surplus cash. Similarly, they cannot dispute that Schenley was prepared to pay out to the minority stockholders $115 million, with the written consent of its long term lenders who apparently shared the view that Schenley could part with such cash without affecting its operations. (U.F.28, A 431-435; 1403-4)*

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* The consent was given by the Prudential Insurance Company as the lender under the long term debt agreement on which $71.5 million was outstanding on December 31, 1970. While the agreement limited the amount Schenley could pay out to acquire its stock to $80 million, Prudential agreed to permit Schenley to pay out $115 million for that purpose on June 7, 1971. (A 1045; 1403-4)

Indeed, from testimony offered by defendants, it can fairly be said that Schenley had between $126 million and $143 million of surplus cash, i.e., cash and liquid assets that were not needed to operate its business.* And Plaintiff's expert testified that Schenley had at least $140 million in surplus cash; that were such an amount to be paid out, Schenley's cash position would still be healthier, by a substantial margin, than that of any of the seven other distilling companies tested by every recognized measurement used by experienced financial officers. Schenley's cash balances immediately after the merger were sufficiently large to enable it, after disbursing $98.5 million in the merger, to purchase additional $10 million of Glen Alden 6% debentures between May 1971 and December 1972. (A 1015; 1391) Thereafter, its cash balances were sufficiently large

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* Mr. Chernow, the chief financial officer of Schenley, believed that Schenley would have enough cash to operate its business after payment of the $12.5 million of debt that matured on the sale of Buckingham and the payment of $98.1 million (or $115 million, if necessary) in the merger, and would not have to convert into cash the $15.9 million of Glen Alden 6% Debentures that were purchased in the open market by Schenley between 1969 and May 1971 (A 418, 421-8). On redirect, Chernow attempted to rehabilitate his prior testimony by stating that after the merger "and to this day" (October 30, 1975), Schenley required and used all its cash for its business (A 869-70).

In Greene the attorney for Glen Alden and Schenley informed the Court that plans for the utilization of Schenley's $150 million of cash would have to be abandoned if the merger were enjoined. (A 1455-7)

to permit Schenley to pay dividends of $26 million to Glen Alden in 1972 and 1973, which amounted to 97% of its earnings (U.F. 44*) in 1972, whereas it had paid dividends of less than 60% of its earnings in 1969 and 1970. (A 104)

B. The Decision to Merge Schenley into Glen Alden

Although Glen Alden could thus foresee in early 1971 that by year end 1971 Schenley would realize the improved earnings and the accumulation of surplus cash that it had anticipated in 1968, it could not reap the full rewards. Unless the Schenley minority stockholders were eliminated, Glen Alden could not withdraw any portion of that surplus cash in the form of increased dividends without giving the minority holders of common stock their pro rata share.

Moreover, any appreciable increase in the current dividend on the common above $1.40 per share would trigger conversion of the $1.40 Preferred into common stock and would threaten to dilute Glen Alden's 86% interest to below 80% and as low as 68% if all the Preferred shares were to convert. In that event, not only would Glen Alden's share of the Schenley surplus cash be reduced, but Glen Alden would lose its right to include Schenley in its federal

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* The Court excluded Undisputed Fact 44 from evidence on the ground it was not relevant to the amount of Schenley's surplus cash. (A 863.21)

consolidated income tax return, a substantial source of cash for Glen Alden. Under the tax allocation agreement between Glen Alden and Schenley relating to such returns, Schenley paid the full amount of its federal tax liabilities, computed on a separate return basis, to Glen Alden. The amount which Schenley paid was a substantially greater amount than Glen Alden's consolidated income tax liability. (A 1014; 1025-26). These considerations made understandable why the Schenley directors did not consider or discuss an increase over the $1.40 dividend being paid on the Schenley common stock, an undisputed fact (U.F. 45) which the District Court refused to admit in evidence. (A 863.22). Riklis testified that "he never heard of" use of surplus cash to increase a dividend (A 276).

Faced with the certainty of Schenley having a huge pool of cash, Glen Alden engineered the merger as the only way to extract the surplus cash without sharing it with the minority stockholders. The terms of the merger were fixed in a manner which gave the benefit of the surplus cash to Glen Alden rather than to the minority stockholders.

C. Terms of the Merger--The Value Attributed to the Schenley Shares and the Glen Alden Debentures

On February 25, 1971, Glen Alden announced a proposed merger with Schenley in which the holders of Schenley common, other than Glen Alden, would receive, for each

Schenley share, $5.00 in cash and $30.00 principal amount of a new 7-1/2% Glen Alden debenture; and the holders of the Preferred would receive 10% less, or $4.50 in cash and $27.00 in principal amount of debentures. Since the debentures concededly were not worth in market value more than 80% of their principal amount (U.F. 6), the cash value of the buyout proposed in the merger was not more than $29 per share for the common stock and $26.10 for the Preferred.*

The total amount to be given to the minority was $16,934,000 in cash and $101,600,000 principal amount of debentures. The debentures were issued by Glen Alden to Schenley for the purpose of the merger. Schenley paid $81.3 million to Glen Alden for the debentures (U.F. 28) so that the use of the debentures in the merger converted Schenley cash (which could have been distributed to its stockholders) into Glen Alden cash and made Schenley minority stockholders involuntary subordinated lenders to

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* According to Allen & Co., Inc., Schenley's financial advisor, the Debentures had a fair market value of 80% of their face. The Proxy Statement did not disclose that the Glen Alden 6% Debentures had a market value between January 1 and May 21 that ranged from 62-1/4 to 53-3/4 per $100 in face amount and closed at 57-1/2 on May 20, 1971 (U.F. 30). The Court below refused to admit U.F. 31, the fact that the Glen Alden 6% Debentures, which ranked pari passu (A 1009) with the 7-1/2% Debentures, were rated "B" by Moody's Financial Service. According to Moody, "Bonds which are rated "B" generally lack characteristics of the desirable investment. Assurance of interest and principal payments or of maintenance of other terms of the contract over any long period of time may be small." (U.F. 31)

Glen Alden.

Meshulam Riklis, Glen Alden's Chairman, and Isidore Becker, President, personally determined that the Schenley minority common shares should be valued at $29.00 and the Preferred at $26.10. They made this decision without the benefit of any prior study, analysis, report or discussion, principally on the basis of the then prevailing market price of the Schenley stock (U.F. 5, 6), which had plunged dramatically since Glen Alden acquired control in 1968 (A 965)*.

The Schenley Board ratified this decision,** subject to the opinion of an investment banker that the terms of the merger were "fair and equitable to the shareholders." Allen & Company, Inc. ("Allen") an investment banking firm that had received $1,200,000 in fees from the Rapid family of companies during the five and one-half years preceding the merger, was hired to give the required opinion (A 954).

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* While Judge Owen concluded that "this consideration represented a price in excess of the market price of Schenley stock at any time since Glen Alden's tender offer," $29.00 equalled the market price of February 24, 1971 but was about two dollars less than the market price of $31.00 earlier that month, and was lower than the market price in any day that month prior to February 22, 1971. (A 1433)

** On February 24, 1971, the Glen Alden Executive Committee ratified the decision of Riklis and Becker; and on February 25, 1971, the Schenley Board followed suit. Mr. Chernow, the chief financial officer and a director of Schenley, had no notice in advance of the meeting that a merger would be proposed (U.F. 8). The Schenley Board approved the terms of the merger in "principle", subject to the receipt of an opinion of an investment banker that the terms of the merger "are fair and equitable to the shareholders of this Corporation." (U.F. 7)

Stanley Shuman of Allen orally told the Schenley directors that the terms were fair on March 25, 1971, and then, after the Proxy Statement was sent to the shareholders, prepared a letter outlining his findings (A 668). The letter dated June 3, 1971, was attached to the minutes of the March 25, 1971 meeting. (A 668) Shuman gave a more detailed opinion on June 7, 1971, in opposition to several suits to enjoin the merger. In that opinion, he stated that "present and historical market prices [were of] overriding significance in valuing securities such as the Schenley stock." (Ex. 49, not reproduced in Appendix) Chernow testified that he could recall no factors other than market prices that were discussed at the meeting of the Schenley directors (A 457-8), nor could he recall that the amount of Schenley's cash and marketable securities was discussed in fixing the merger terms (A 461-3).

Unlike Glen Alden and the investment bankers who had evaluated Schenley for Glen Alden in 1968, Shuman, like the Schenley directors, effectively disregarded Schenley's huge pool of cash in valuing the enterprise (A 452; 457; 463; 717-723; 725-737).

ARGUMENT

I

THE PROXY STATEMENT FAILED TO DISCLOSE MATERIAL FACTS ABOUT THE VALUE OF SCHENLEY'S STOCK IN VIOLATION OF RULE 10b-5 AND RULE 14a-9

INTRODUCTION

In an appraisal proceeding in Delaware brought by certain Schenley stockholders who declined to accept the Glen Alden debentures in the merger, the appraiser (in his Report, A 883 et seq.)* found,

> Subsequent to August 6, 1968, the point at which time Glen Alden secured control of Schenley, the market witnessed the phenomena of Schenley's declining market price coincident with its improved sales performance, and fundamental changes within the Schenley corporate structure. The inconsistency between Schenley operating and financial performances on the one hand and its market performance on the other hand is subject to various interpretations and hypotheses. . . ."**

The proxy material failed to point to this inconsistency or the reasons for it, and correspondingly failed to indicate any basis for believing Schenley stock was worth considerably more than its market price.

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* The Appraiser filed a Draft Report which was "decided" July 18, 1974 and, except as modified (in respects not here relevant), its findings were incorporated in his Final Report, decided Sept. 14, 1974.

** The Delaware Vice Chancellor offered one explanation--the gloomy overhang of Glen Alden's control depressed the price of Schenley's minority publicly held shares. Greene v. Schenley Industries, Inc., 281 A.2d 30, 35 (1971).

This treatment contrasts sharply with the treatment of the same kind of contradiction in the November 17, 1969 Schenley proxy statement to the Schenley and Buckingham shareholders on the Buckingham merger into Schenley. In that proxy statement, Schenley informed Buckingham stockholders it might possibly resell the Buckingham stock at a price higher than it was paying the minority shareholders, and it pointed out that the investment banking firm of Bear, Stearns & Co., which had made a study of the matter for Glen Alden, "had expressed the opinion as part of its evaluation of the stock of Schenley that the outstanding shares of stock of Buckingham at that time 'might well be valued', on an earnings multiple basis, at substantially in excess of their then market price..." (A 1079) The Bear, Stearns report had previously indicated to Glen Alden that the market price of Buckingham public shares would be higher if there were no "dominant controlling shareholder." (A 1318). While this same situation existed in 1971, as between Schenley and Glen Alden, the 1971 Proxy Statement gave no clue to the disparity between the fair value of the Schenley stock and its depressed market price.

The significance of the inadequacy of the proxy materials is underscored by the identity of the stockholders who were the leading claimants in the Delaware appraisal proceedings. Lewis Rosensteil (founder and controlling stockholder of Schenley until 1968) and his family were the equitable owners

of approximately 80,000 shares of Preferred and Milton J. Nauheim, a director of Schenley until 1968, was the owner of approximately 10,000 shares. They both sought appraisal. Neither of them was dependent upon information in the Proxy Statement to alert them to the real value of Schenley stock. What the Proxy Statement failed to tell the public stockholders, Rosensteil and Nauheim knew from their past association with the company, and they preferred to accept the risk and expense of an appraisal proceeding instead of the price offered in the merger. That they were accurate in understanding that Schenley stock was worth more than the $29 offered is apparent from the results of the appraisal proceeding in which the appraiser*(who had before him the Graham and Bear Stearns Reports*) reached a value of $43.87 per share for Schenley common stock.

While the Delaware Vice Chancellor reduced this amount to $33.86** per share, even that figure is approximately 17 percent more than the amount offered in the merger.

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* See Appraiser's Draft Report pp. 11-14, appended to this brief (A 883 et seq.)

** In 1971 in Greene v. Schenley Industries Inc., 281 A.2d 30 (1971), Vice Chancellor Marvel refused to grant a temporary restraining order against the 1971 merger because he found the terms to be sufficiently likely to be "fair and equitable" to require the challengers to bear the risk of the merger being proved improper later. Three years later, after the appraiser whom he appointed found the Schenley shares to be worth 50% more than had been offered in the merger, Vice Chancellor Marvel reduced the factor of unfairness to 17%, Gibbons v. Schenley Industries Inc., 339 A.2d 460 (1975).

Plainly there was information about Schenley that was not contained in the proxy materials in 1971 that might, if revealed, have given the public stockholders the same stimulus to seek appraisal that motivated those who were more familiar with Schenley's past and potential. To that information and to Schenley's obligation to have disclosed it, we now turn.

1. Schenley's Obligation to Disclose Material Facts

The conclusion of the court below that the Proxy Statement adequately disclosed the material facts is itself an inference from documentary evidence and essentially uncontradicted oral testimony, rather than a finding of basic facts, so that it is not necessary for appellants to bear the burden of Rule 52(a) in asking this Court to reach the opposite conclusion. See e.g. Orvis v. Higgins 180 F.2d 537 (2d. Cir. 1950), cert. den. 340 U.S. 810 (1950); U.S. ex rel Lasky v. La Vallee 472 F.2d 960, 963 (2d. Cir. 1973); In re Beck Industries, Inc. 479 F.2d 410, 412 n. 3 (2d Cir. 1973) cert. den. 414 U.S. 858 (1973); Reyher v. Children's T.V. Workshop 533 F.2d 87. 90 (2d Cir. 1976). But even if that were not so (compare 5A Moore's Federal Practice § 52.04 pp. 2677-2688 (1975) with Wright and Miller, 9 Federal Practice and Procedure § 2587 pp. 740-749 (1971)), appellants would be wholly unencumbered by that burden because the court below erred in predicating its conclusions on an improper standard by which to measure the adequacy of the Proxy Statement. Wright & Miller, 9 Federal Practice and Procedure § 2585 at p. 734 (1971); 5A Moore's Federal Practice § 53.03 [2] p. 2664 (1975); SEC v. Texas Gulf Sulphur Co. 401 F.2d 833, (2d Cir. 1968) cert. denied 394 U.S. 976 (1969). It per-

ceived the central issue to be "whether or not Schenley was required to characterize certain facts in a particular way, notwithstanding that they were otherwise essentially disclosed in the Proxy Statement," (op. p. 2) and in resolving that issue, it relied exclusively on cases involving arms' length transactions--a contested tender offer (Corenco v. Schiavone Sons Inc., 488 F.2d 207 (2dCir. 1973), a 1933 Act registration statement in a contested tender offer (Feit v. Leasco, 332 F.Supp. 544 (E.D.N.Y. 1971), and a case involving frustration of a take-over effort, coupled with responses in supplementary proxy materials to specific claimed omissions and misrepresentations (Abramson v. Nytronics, 321 F.Supp. 519 (S.D.N.Y. 1972)). But the standards of disclosure which appellees should have met and which the court below failed to apply in this case, are considerably more demanding than those governing arms' length tender offers or proxy contests or even 1933 Act registrations.

The essential reason why more is required by way of disclosure in soliciting literature in cases like this is that in the context of tender offers or proxy contests, offerees can reasonably expect to receive the assistance of their own management or of the opposition. Any inadequacies of expression or disclosure may be overcome by the opposition or by the target's management. Spielman v. General Host Corp., 402 F.Supp. 190, 194, 195 (S.D.N.Y. 1975); McConnell v. Lucht, 320 F.Supp. 1162, 1165 (S.D.N.Y. 1970). Compare Chris-Craft Industries Inc. v. Piper Aircraft Co., 480 F.2d 341, 377, 401 (2nd Cir. 1970), cert. denied 414 U.S. 910 (1973); Smallwood v. Pearl Brewing Co., 489 F.2d 579, 60[illegible] (5th Cir. 1974), cert. denied 419 U.S. 873 (1974); Electronics Specialty Co., v. International Controls Corp. 409 F.2d 937, 948-9 (2nd Cir. 1969). In this case,

we are concerned with circumstances in which no contest exists, and displacement of the public stockholders is forced by the majority. Stockholders have only their own management to rely upon to give them the relevant material to make a choice. We are concerned, in short, with the disclosure obligations of a self-dealing fiduciary in a unilateral transaction.

Those obligations demand fuller and more meaningful disclosure than is required in a proxy contest or a tender offer. Blanchette, et al. v. Providence & Worcester Co., [Current] Fed. Sec. L. Rep. (CCH) ¶ 95, 869 (D.Del. 1/17/77) In this case, as in the Blanchette case at 91,201, "...defendants were not only in a sense insiders, but in their capacity as officers and directors ... were fiduciaries for the stockholders. This imposed upon them the heavy responsibility for advising the stockholders fully and impartially about the advantages and disadvantages of the . . . [merger], especially in view of the personal interest which the defendants had in the success of the...[merger]." To meet those responsibilities, there is no "justification for anything but the most straightforward and fullest disclosure" Broder v. Dane 384 F. Supp. 1312, 1318 (S.D.N.Y. 1974). Like a corporation seeking to repurchase its own stock, the obligations of Glen Alden and Schenley's management in this case are "greater than an outsider's because of [their] . . . complete access to internal information, . . . [the] ease of communication with security holders, and their expected confidence in" the management. Id. at 1319. See also Tannenbaum v. Zeller, [Current] Fed. Sec. L. Rep. (CCH) ¶ 95,900 (2nd Cir., 3/4/77), at p. 91,346 et seq.

Hence, while we submit that the court below erroneously concluded that the Proxy Statement was adequate even on the standards which were applied, we believe that the proper standards are more demanding, that the court below erroneously failed to apply the correct fiduciary standards of disclosure, and that if tested by those standards, the Proxy Statement was wholly inadequate.

Examination of the proxy materials in their entirety reveals a document which is designed not to advise beneficiaries "fully and impartially of the advantages and disadvantages" of the merger but at most to meet grudgingly with minimum legal standards applicable to an arms' length takeover. Its failure, even in that respect, is not avoided by the fulsome warning with which it begins, that because Glen Alden has the votes to force the merger and has elected the Schenley Board which approved the merger, readers should give the proxy material "more careful scrutiny" than they otherwise might. An admonition to one's victims to be careful how they grope their way through the dark does not excuse keeping them in the dark.* The question here is whether the Proxy Statement did, as it should have, shed light to guide the readers or cast shadows to confuse them.

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* In this respect, our case differs from Rosenblatt v. Northwest Airlines, 435 F.2d 1121 (2nd Cir. 1970) where the admonition that there might be a conflict or divergence of interest was sufficient to eliminate the necessity to spell out the details of the possible conflict. Here the information concealed goes to the value of the enterprise rather than to elaborating the stated conflict of interest.

Similarly, extensive references in the Proxy Statement to litigation challenging the fairness of the merger are no substitute for information in Schenley's possession which would have shed light on the questions of value and fairness.

2. The Inadequate Disclosure of the Development of Schenley's Surplus Cash Between 1968 and 1971

The court below correctly stated (Op., p. 2) that he facts about Schenley's cash position and the growth of henley's cash ... are not in dispute", but it erred when stated that these facts and sources were "adequately dis-sed." In order for stockholders to understand the value Schenley's stock, it was essential that the Proxy State-nt point out that during the three years between 1968 and 71 Schenley developed a cornucopia of surplus cash, with-t any diminution in its earning power. Not only was there explicit statement of such developments in the proxy terials, but all allusions to the matter were opaque and served to conceal more than to reveal.

First: Page 3 of the Proxy Statement indicated that Schenley had $72 million in cash at December 31, 1970 and $162 million in cash after the sale of Buckingham (A 952).*

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* In fact, Schenley had $191 million in cash after the sale of Buckingham. The $29 million difference was comprised of two parts: approximately $14 million in cash and irrevocable letters of credit due in November 1971 from the February 1971 sale of Schenley's wine business (A 993); and $15.8 million of Glen Alden's 6% Debentures, marketable securities which Schenley owned as of March 3, 1971 (A 1015) (UF 30). While the Proxy Statement (A 993, 1015) contained the information about the additional $29 million, only a sophisticated reader would not be misled by the $162 million figure stated prominently on page 3. Judge Owen erroneously stated that plaintiffs used "a post proxy, unaudited balance sheet" (Op. p. 5, Note 3) to arrive at the $191 million figure. In fact, plaintiffs used the information within the Proxy Statement itself. If the court below could be confused by the information which was scattered and hidden throughout the Proxy Statement, it is not surprising that even a reasonably intelligent shareholder would be misled.

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However, more important to the shareholders than the total amount of cash then on hand was the tremendous amount of cash that was generated during the three year period. Yet the Proxy Statement does not point up for a stockholder that such cash was generated without sacrificing earning power. A comparison of balance sheets does not reveal the improvement in cash, unless one compares a series of balance sheets--which were not available in the proxy materials.*

Defendants point to the 1969 and 1970 Schenley balance sheets on page F-24 through F-25 and the statement of consolidated changes in working capital on page F-27 of

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* The court below, erroneously believing itself limited by the SEC requirement of two years of balance sheets in a merger proxy statement, mistakenly refers to the suggestion in Corenco Corp. v. Schiavone & Sons, Inc. 488 F.2d 207 (2d Cir. 1973) that when a tender offeror is compelled at the suit of a target company to file financials under section 13(d), two years is a sufficient period for reporting its financial results. But in that case, the Court was imposing a new requirement of disclosure made necessary by the context of the transaction even though no such disclosure was prescribed by Commission rule. The real teaching of Corenco is that when more disclosure than the Commission rules require is made necessary by the context, such disclosure should be made (Corenco, supra at 214, note 8). This too is the teaching of the Commission. In Re Franchard 42 S.E.C. 163 (1964). Hence Corenco doesn't limit required disclosure to two years. On the contrary it suggests that more may be needed if the context requires. Thus, while figures for two years may be all that is needed from an arms-length tender offeror to disclose its financial condition when it is offering to pay only cash, that period is hardly sufficient to reveal the growth of surplus cash when a self-dealing management is obligated to inform its own stockholders of developments in the company preceding a merger which it is forcing upon them.

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the Proxy Statement. Even if the reader of the Proxy Statement had the foresight to compare the proposed information about Buckingham on page 3 and page 44 of the text with these financial statements at the back of the Proxy Statement, he or she could not discern either the improvement over the total period or the extent to which the cash was surplus. (A 1039, 1040, 1042, 952, 993)

We need not explore all the possibilities of adequate communication in this case, but at the very least the Proxy Statement could have contained, in a prominent position, a statement similar to Ex. 147 (A 1434). Ex. 147 evidences the amount of cash Schenley had periodically each year between 1967 and 1971 as it conducted its operations, so that a reader could get some sense of the accumulation of surplus cash* apart from the $90 million derived as net proceeds from the sale of Buckingham stated at page 3 of the Proxy Statement.

Nor is there anything--such as a statement or a chart--in the proxy materials to permit comparison of Schenley's cash position with that of comparable enterprises

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* Between August 1967 and December 1968 the amount ranged from approximately $14,500,000 to $19,500,000 and thereafter from $30,000,000 to $191,000,000.

in the liquor industry, from which the shareholders could consider whether Schenley's cash was excess.*

It is not necessary to press for a comparison in the Proxy Statement of precise cash positions among Schenley and its competitors in order to reveal adequately the fact that Schenley's cash was in excess of its needs. It would have been enough for Schenley to have taken a leaf from Glen Alden's prospectus on its initial tender offer for Schenley stock in 1968, in which Glen Alden informed Schenley's stockholders that "Schenley believes that its inventories of whiskeys and its productive capacity are greater in relation to its total sales than

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* Appellants' investment banking expert, George Dormer, testified that Schenley had approximately $140 million in surplus cash in May of 1971. Dormer used the same definition of "excess" as Bear, Stearns had used in 1968 (A 821). Dormer made his determination by comparing Schenley's balance sheet with those of seven other companies in the distilling industry. These are precisely the same liquor companies which Bear, Stearns used in 1968, with one unimportant exception. (A 84, 1438-1453 and A 1337).

Mr. Dormer's comparison shows that by May 1971, Schenley had $191 million in cash and marketable securities, constituting 31% of sales, while the next highest cash rich company had approximately $58 million in cash and marketable securities, constituting 5.6% of sales. (A 822, 1438-39).

The removal of $140 million of Schenley's surplus cash would still have left Schenley with almost twice as much cash as a percent of sales (4.1%) as the average in the industry (2.3%) (A 828, 1444).

is the case in the industry in general." (A 1226). Schenley was able to repeat that admonition in its Buckingham proxy statement (A 1094). Surely the import of excess cash in 1971 was not less material to the readers of the merger proposal in 1971 than was the import of the excess inventories in 1968 and 1969 to the readers of those documents.

Second: That Schenley's cash was surplus--and was known to management to be surplus--to the extent of at least $140 million is hardly open to dispute. Not only was the creation of precisely such surplus Glen Alden's objective in seeking to acquire Schenley (supra, pp. 6 - 8), but its success in achieving that objective was attested by Riklis in this proceeding ("$80 to $120 million" in cash alone - A 296) and publicly in Forbes magazine; by Schenley's chief financial officer (Mr. Chernow, $126 to $143 million, supra, p. 16); and by Schenley's counsel in the argument before the Chancellor on the request for a temporary restraining order (Greene v. Schenley Industries, Inc., 281 A.2d 30 (1971))*

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*Mr. Arsht informed the Court that Schenley not only had $150 million in surplus cash, but also had plans to use this money.

> "Additionally Mr. Levy [plaintiff's counsel] has pointed out and said Schenley has some $150,000,000 of surplus cash. It has. That is one of the facts in the case. As the Court might expect, and as the Court would have a right to criticize if management had not made plans for the utilization of this amount of cash, the defendants have.

(ft. cont'd)

Yet the most that can be found in the proxy material is an allusion on page 1 to the transfer of "substantial funds" of Schenley (see also p. 43) and the further statement on page 3 that "a substantial part of proceeds ... from the recent sale of Buckingham" would "provide a source for payment of current maturities of Glen Alden's long term debt", which was effectively stated to be $47 million. The suggestion that only $47 million* was to be transferred and

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(ft. cont'd)

> Now, if plaintiffs should succeed in this attempt to get a preliminary injunction, defendants' plans for the utilization of that cash will have to be abandoned. The damage that would result from that abandonment would be tremendous..." (A 1455-1457).

Plaintiffs have defined surplus cash as the cash that can be separated from Schenley without materially affecting its operating profits. Mr. Arsht has used the term "surplus cash" both in haec verba and in a functional sense by stating that "defendants' plans for the utilization of that $150,000,000 will have to be abandoned if Glen Alden is not permitted to merge with Schenley." Obviously, the $150,000,000, at the time Mr. Arsht spoke, was not to be used in Schenley's business. An injunction was not needed to prevent Schenley from using its own cash for its own corporate purposes.

* Directly under the statement on page 8, it was stated that Glen Alden's current maturities of long term debt amounted to $77 million. But, next to the $77 million figure, was a reference to a footnote which stated explicitly that $30 million of the $77 million was paid on February 1, 1971, leaving a balance of $47 million in current maturities of long term debt. Consequently, a reasonable reading of the term "substantial funds," in the context of the Proxy Statement indicates that "substantial" could mean $47 million or less. It would be $47 million if the funds which were to be transferred would provide the only source of payment of Glen Alden's current maturities of long term debt. The term "substantial" could be less than $47 million if this amount was to provide a source, rather than the only source. A shareholder could not infer from the word "substantial" how much of Schenley's cash was to be transferred and was surplus.

therefore was surplus is misleading, in view of Schenley's transfer of $81 million to Glen Alden for its debentures (on which the merger rested) to be used for Glen Alden's purposes; its payment of $17 million in cash to buy out the minority shareholders; and the existence of other liquid assets not necessary for Schenley's business such as the $15.8 million in Glen Alden debentures and the $14 million from the sale of the wine business.

Third: Precisely the same issue of surplus cash arose in Feit v. Leasco Data Processing Equipment Corp., 322 F. Supp. 544 (E.D.N.Y. 1971), where the Court held that the failure to include an estimate of a target company's surplus cash in a registration statement filed in connection with a tender offer was a material omission:

> "While disclosing masses of facts and figures, it [the registration statement] failed to reveal one critical consideration that weighed heavily with those responsible for the issue--the substantial possibility of being able to gain control of some hundred million dollars of assets not required for operating the business being acquired."

Like the existence of surplus in Feit v. Leasco Data Processing Equipment Corp., 332 F.Supp. 544 (E.D.N.Y. 1971), the existence of excess cash goes to the heart of the accuracy of the value placed upon the Schenley stock, and, therefore, to the essence of the choice the investor was asked to make by the merger proposal. Like Leasco's management, which commissioned a report

from an investment banker on the target concerning surplus cash, Glen Alden had commissioned a similar report, knew of the excess cash, and had respectable estimates of the amount involved.

The trial court distinguished this case from Feit by stating that the Proxy Statement disclosed that Buckingham was sold, while Leasco's registration statement did not mention the existence of the surplus cash.* Apart from Schenley's obligation to its own shareholders to make the matter plainer to them than Leasco's obligation to Reliance's shareholders,** the distinction is untenable. Certainly the sale of Buckingham was the largest single source of Schenley's cash improvement, but that sale accounted for less than one half of the total improvement in Schenley's cash position. More-

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* The judge's contrast between our case and Feit, whose disclosure documents he felt were defective because they involved "no disclosure of the existence of unusable cash" (Op., p. 8) is ironic in view of the fact that the balance sheet in Feit revealed no less an accumulation of liquid assets than is revealed in our Proxy Statement. (A 937-939)

** Unlike Feit, the defendants in this case are self-dealing insiders who owe a fuller and plainer explanation of the unilateral transactions they were forcing, (including the gains to be expected from their self-dealing) than do outsiders in a take over effort. If existence of surplus cash (earning power) should have been disclosed by outsiders to its stockholders under Feit, the growth of Schenley's surplus cash (accomplised without affecting earning power) certainly should have been disclosed "fully and impartially" by the self-dealing fiduciaries of Schenley. No such disclosure was made by them.

over, the central teaching of Feit, which the trial court ignored, was the significance of the failure of the document sent to Schenley's shareholders to disclose the one critical consideration which weighed heavily with those responsible for its issue--the fact that the bulk of the cash was not required for operating Schenley's business. A management concerned with letting its stockholders understand the value of their enterprise could certainly have stated more plainly the amount of the surplus cash or offered a better clue than can be found in the financials at the back of the Proxy Statement.

These facts are of critical importance because they enable a reasonably intelligent minority shareholder to infer that what Graham had advised Riklis in 1967 had come true: Glen Alden had separated Schenley into two separate companies: an operating company and a "bank" of surplus cash. In deciding how to vote, the same shareholders would have asked whether the $29.00 price being paid included their fair share of the "bank."

The existence of surplus cash in an enterprise which, like Schenley, generated that cash while increasing its revenues and income has a well recognized significance in appraising the value of an enterprise. Scholars in

treatises* and texts**, as well as practical minded analysts***, uniformly acknowledge that such "redundant cash" enhances the value of a profitable industrial enterprise like Schenley-dollar for dollar-over its capitalized earnings. As Bonbright has pointed out:

> "The appraiser often discovers many assets which may be sold or which may be distributed directly to security holders, without impairing the going concern. Redundant cash and other treasury assets fall into this category. They may properly be valued without reference to the earning power of the business, and their separate net realization value may be added to the value of the going concern ... to disclose what the entire property of the company is worth." Bonbright, supra, p. 283-239.

Finally, it may be noted that the proxy materials suffer from another pervasive defect which obscures the crucial elements of information presented to stockholders -- "piecemeal presentation" of bits of information "scattered throughout the proxy materials." Kohn v. American Metal Climax, 458 F.2d 255, 265 (3rd Cir. 1972) cert. denied 409 U.S. 874 (1972). As the District Court pointed out in that case

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* James C. Bonbright, Valuation of Property, A Treatise on the Appraisal of Property for Different Legal Purposes (1st Ed., 1937) Vol. 1; A.S. Dewing, The Financial Policy of Corporations(5th Ed. 1953) pp. 282-283 and 392-399).

** P. Hunt, C. Williams and G. Donaldson, Basic Business Finance: Text & Cases, (4th Ed. 1971); Guthmar. and Dougall, Corporate Financial Policy, 567 (4th Ed. 1962).

*** Graham, Dodd, Cottle and Tatham, Security Analysis (4th Ed. 1962, p. 564). Excerpts from the opinions of the foregoing authorities are appended to this brief.

> "The Securities Exchange Act requires more than disclosure, it requires adequate disclosure. The more material the facts, the more they should be brought to the attention of the public. To view it otherwise would be to invite frustration of the policies underlying our disclosure laws. Accordingly, we have found certain facts to be "buried" in the explanatory materials. These facts should have in some way been highlighted to insure that the shareholders were aware of them. We need not speculate as to how this should have been done. One obvious way does, however, come to mind, namely, these facts could have been placed on the cover page in bold-face type. Nevertheless, their present location is not justified by their importance, expecially in view of the length and complexity of the explanatory materials." Kohn v. American Metal Climax, 322 F.Supp. at 1362.

See also Norte & Co. v. Huffines, 304 F.Supp. 1096, 1106 (S.D.N.Y. 1968) aff'd 416 F.2d 1189 (2nd Cir. 1969); Gould v. American Hawaiian SS Co., 331 F.Supp. 981, 995 (D. Del. 1971) aff'd on this point 535 F.2d 761 at 773-74; Blanchette, supra.

Even if analysis of Schenley's balance sheet and financial statements and study of financial manuals would have enabled "sophisticated investors" to infer the truth about the value of Schenley's excess cash, it is the purpose of the securities laws to ease that burden on the ordinary investor. If so accessible a notion as the difference between the par value and the market price of stock was held to require explicit statement in Rosenfeld v. Black, 445 F.2d 1337, 1349 (2nd Cir. 1971), cert. dismissed 409 U.S. 802 (1972), in part because of the "fiduciary relation"

between management and the shareholders with whom they were communicating, something more than appears in Schenley's Proxy Statement was owing to its public stockholders to make them aware of the impact on the value of the enterprise of the surplus cash which had been generated without diminution of earning power.

3. Inadequacy of Disclosure of Management's Assessment of the Value of Schenley Stock

The culpability, as well as the significance, of Glen Alden's failure "fully and impartially" to reveal the substantial basis for valuing Schenley's stock at more than its pre-merger market price is underscored because Schenley's management understood, but declined to set forth clearly, the import of its success in maintaining--and indeed increasing--Schenley's earnings while generating such a mass of surplus cash. Such disclosure is required by Galfand v. Chestnutt Corp., 545 F.2d 807 (2d Cir. 1976).

First: Buried in Note D to its financial statement at page F-13, the Proxy Statement discloses, in dense accountants' language, that the management of Glen Alden was of the opinion that there had been no decline in the value of its investment in Schenley since its acquisition in 1968 at a price of $58.80 per share. However, it was in the defendants' interests to conceal from the Schenley minority shareholders that Glen Alden

felt justified in carrying its Schenley shares at a price of at least $58.80 per share at the time that the defendants valued the minority's stock at $29.00 per common share. Hence the information was stated opaquely in Glen Alden's balance sheet and not alluded to in the text of the Proxy Statement.

This mode of treating the matter contrasts sharply with Rapid's treatment of the same matter when it was to its interest to give it wider publicity. Thus when Glen Alden merged with Rapid in 1972,* Glen Alden's opinion that the value of its Schenley investment had not declined since acquisition appeared in the text of the document. It was in Rapid's interest to tell the readers that while its equity in Glen Alden consisted almost entirely of intangibles representing excess purchase price over net tangible assets of companies acquired by Glen Alden, those investments had not declined in value since acquisition.**

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* Rapid was the owner of 63.7% in 1971 (A 951) and 88% in 1972 of Glen Alden common stock (A 180).

** The intangibles attributed to Glen Alden's investment in Schenley were "1970-$85,583,000; 1971-$68,448,000 and in other Glen Alden subsidiaries (1970-$43,045,000; 1971-$33,726,000" and $50 million in "Franchises". (A 1420 and UF 37) The Franchises consisted of Schenley's right to import and distribute Dewars Scotch in the United States (A 994, 612-14). A decline in the value of Glen Alden's investment in Schenley would reduce the value of Rapid's investment in Glen Alden and lower the extent of its participation in the 1972 merger with Glen Alden because of the predominance of senior securities of Glen Alden held by the public and others (A 961-962).

The 1972 Proxy Statement contained the 1971 Glen Alden financial statements with Note D appended to it, just as our Proxy Statement contained the 1970 financials. However, unlike our Proxy Statement, the text of the 1972 statement clearly disclosed the critical opinion of management that there had been no decline in the value of its investment in Glen Alden and in Schenley.*

In Feit v. Leasco Data Processing Equipment Corp., 332 S.Fupp. 544 (E.D.N.Y., 1971), defendant Leasco employed similar tactics when, in an earlier prospectus under which it sought to buy Reliance common stock, Leasco concealed the existence and amount of the former's surplus surplus. Nine months after acquiring the Reliance stock, when Leasco

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* The text stated that:

> "(a) The book value per share of Glen Alden Common Stock set forth herein is based upon common stockholders' equity of $136,297,000, which includes 'excess of cost of investments in subsidiaries over related equities' of $102,174,000, or $5.85 per share. The book value per share of Rapid Common Stock set forth herein is based upon common shareholders' equity of $190,456,000, which includes 'excess of cost of investments over related equities' of $193,479,000, or $26.91 per share. In the opinion of the respective managements of Glen Alden and Rapid, such excess costs are similar in nature to intangibles which have not declined in value since acquisition of the related equities. See Note D of Notes to Financial Statements of Glen Alden and Note 5 of Notes to Financial Statements of Rapid." (UF 35)

sought to sell its own stock (Id. p. 574), it considered the amount of the Reliance surplus surplus "material and accordingly included such information." The Court said such later disclosure of what should have been disclosed earlier "has great evidenitary value in evaluating the significance and impact of such disclosure on potential traders." (Id. p. 574)

Second: The inhibitions on setting forth management's opinion of the enterprise's value in a proxy statement do not mean that when its opinion, based on ample evidence, suggests a considerably higher value than do the company's books or the terms of the merger it offers to minority stockholders, it is permitted to conceal or obscure the basis for its opinion. When management has reason to believe that the value of the enterprise is substantially higher or lower than is reflected in the company's books it has the duty to point up those differences and the reasons therefor. Glen Alden's failure in this case to intimate, let alone to make clear its basis for the value it had placed on Schenley is comparable to the failure adequately to state the values involved in Chris-Craft Industries Inc. v. Independent Stockholder's Committee, CCH Fed. Sec. L. Rep. ¶ 93,766 at p. 93,351; (D. Del. 1973); S.E.C. v. Bangor Punta Corp., 331 F. Supp. 1151, 1161 (S.D.N.Y., 1971); aff'd 480 F.2d 341, 366-369, (2d Cir. 1973); Gerstle v. Gamble Skogmo Inc., 478 F.2d 1281 (2d. Cir. 1973).

In the latter case which, like this case, involved the absorption of a subsidiary by a parent, there was a failure, not merely to disclose the appraised value or the other evidence of value which management had (and which revealed a significantly larger value for the assets than the books showed), but to give adequate suggestion that the books understated the value of the assets. A reference in the proxy statement to the fact that there was an "excess of realizable values, as appraised by management, over net book values ..." was held by the District Judge to be inadequate to inform the stockholders because "the amount of this excess was not set forth in either the notes or the textual statement of the proxy material. . . ." 298 F.Supp. 66, 91. An oblique allusion to hidden assets is not sufficient if stockholders are not given any real indication of the magnitudes involved. The reference in this case to "substantial" amounts is no more adequate than was the reference to "excess. . .values" in Gamble Skogmo. While that holding of the District Court was modified on appeal by this Court, the modification was required not because the challenged statement was found to be adequate to inform the stockholders of possible hidden values, but because at that time the SEC proxy rules were understood to forbid the use of management's appraisals of fixed assets in financial statements. 478 F.2d 1281, 1294-1295 (2nd Cir. 1973). This Court affirmed the essential inadequacy of the disclosure in that proxy statement in language that bears repetition here. The stockholders of Schenley were not required to hire "the sensitive antenna of investment analysts" to probe for meanings that their own management had a unique obligation to make explicit in view

of its conflict of interest. (Id. 1297)

To be sure, Gamble Skogmo (478 F.2d at 1294) and Kohn (458 F.2d at 265) point to the difficulty of permitting, let alone compelling, insertion in proxy materials of management's unchecked appraisals that the value of the stock exceeds its market price. But neither case requires that a material disparity between the merger-market price and intrinsic value, as appraised by outsiders, should be ignored, especially when it is to management's interest and against the shareholders' interest to ignore that disparity. On the contrary, reference to offers by outsiders (Gamble Skogmo at 1294-5 , S.E.C. v. Bangor Punta Corp. supra 480 F.2d at 366-9) or appraisals by outsiders (see Schenley 1969 Proxy Statement, A1079 and 1094) is recognized as an appropriate vehicle for satisfying the need to suggest the possibility of the disparity.

Management's failure to give any indication of the possibility that the value of Schenley might be considerably greater than the market price of its stock is magnified by the curious references to "Allen & Company, Incorporated" on page 5 of the Proxy Statement. That firm was identified as "an investment banking firm" which "acted as adviser to the Board of Directors of Schenley in connection with the proposed reorganization and has advised the Board that in their opinion the terms of the proposed reorganization are fair and equitable to the holders of" Schenley common and preferred stock. To be sure, the independence of that firm's opinion is qualified on two counts. First, there is a statement of its employment by, and receipt

of substantial remuneration from Glen Alden and Rapid in other connections. Second, there is the statement that the firm's inquiry into the fairness of the exchange was based "on information furnished by Glen Alden and Schenley and on published financial data" and that the firm "did not make any independent factual investigation of the affairs of either Schenley or Glen Alden." If the references to prior payments to the firm and to its failure to make any independent investigation were omitted from the Proxy Statement, there is no doubt that the use of Allen's opinion as to fairness would be misleading. See Kohn v. American Metals Climax Corp. 458 F.2d 255, 268; Denison Mines v. Fibreboard ~~Corp~~. ~~388~~ F. Supp. 812, 821-822 (D.Del. 1974).

We submit that that misleading impact is not cured by the appearance of candor created by the two qualifications. The essential issue here is whether the proxy materials fairly revealed the value of Schenley, particularly in view of the additional value of its surplus cash, and the possible disparity between that value and the market price (and merger price) of its stock. To proffer Allen's opinion as an outsider, notwithstanding the explicit qualifications, is to offer an express affirmation of value which management had good reason to doubt, or at least to know it had evidence which might cause stockholders to doubt.

If Allen & Company's opinion had not been spelled out, management's obligation to offer evidence which suggests the possible disparity between intrinsic value and market price might have been less. But with Allen & Company's opinion offering an outside affirmation

of fairness, management's obligation to reveal contra-indications is as plain as it was unfulfilled. Galfand v. Chestnutt Corp., 545 F.2d807, 811-813 (2d Cir. 1976. S.E.C. v. Bangor Punta Corp., supra, 480 F.2dat 366-9.

Management's failure in this regard did not consist only in its obscuring its judgment that the value of its investment in Schenley had not declined is all the more culpable in view of its demonstrated ability to utilize the contra-indications of value held by other outside experts to qualify the statement of market price in the proxy materials in the Buckingham merger of November 1969. (See p. 23 supra) Management was perfectly able to inform the Buckingham shareholders that Bear, Stearns had expressed the opinion that the value of the Buckingham stock might be substantially in excess of its market price. If the later prospectus in Feit (at 656-6) showed an ability to proffer estimates of value which infected the earlier prospectus' failure to do so, the 1969 proxy material (A 1079) in our case underscores the inadequacy of the May 1971 Proxy Statement. And that inadequacy is not mitigated by the failure to allude to views offered by Riklis, a few months earlier, in the Forbes interview.

4. The Inadequate Disclosure of the Disparate Treatment of Schenley's Public Stockholders and Glen Alden in the Merger

The disparity between the distributions made to Schenley's public stockholders and to Glen Alden in the merger offered clues about Schenley's real value from which stockholders

might more intelligently determine whether to seek appraisal or resist the merger. Yet in two crucial respects the Proxy Statement failed adequately to point out that disparity or at least to suggest its import.

First: Although it perhaps was possible for a "sophisticated investor" to ferret out of the proxy materials the potential gain to Glen Alden from the freeze-out of the public stockholders of Schenley at $29 per share, that notion was not suggested, let alone "fully and impartially" (Blanchette, supra at 91201) revealed to an unaided stockholder. The effect of the Schenley-Glen Alden merger was to increase the amount of the latter's interest from 68 percent (on a diluted basis--assuming full conversion of the Preferred into common stock) pre-merger to 100 percent post-merger. While the Proxy Statement contained a pro-forma balance sheet at page 44 which reflected the sale of Buckingham and the resulting increase in Schenley's net worth to $417.5 million, it did not point out that as a result of the merger, Glen Alden's 68% pre-merger interest in Schenley's stockholder equity of $417.5 million would increase to 100%, an increase of $134.6 million-- at a cost of $98.3 million, or a gain of $36.3 million.*

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* According to the Glen Alden pro-forma balance sheet at page 25 of the Proxy Statement which reflected the effects of the proposed merger, Glen Alden would pay the $16,934,000 to the Schenley minority (A 974) and would issue the debentures. Since the debentures would in fact be issued at a discount of 20% the economic cost to Glen Alden was only [illegible] of their principal amount.

Second: The proxy statement did not disclose (a) the magnitude of the cash benefit to Glen Alden from the merger or (b) the significance of the transfer of Schenley's surplus cash to Glen Alden for Glen Alden's exclusive use while the public stockholders as the holders of the debentures became simply subordinated lenders to Glen Alden (A 1008-9) instead of recipients of their pro-rata share of that cash.

Neither Schenley's transfer of $81 million in cash to Glen Alden for the 7-1/2% debentures to be used in the merger, nor, as we have shown, the additional surplus cash that was available for transfer to Glen Alden was set out in the Proxy Statement. It is difficult to know how Judge Owen concluded at page 7 of his opinion that the reader of the Proxy Statement "knew" that Schenley would buy the debentures from Glen Alden, because that information was not available to the reader of the Proxy Statement. The plan and the agreement of merger, which was annexed to the Proxy Statement as an exhibit, indicated that either Glen Alden was going to issue the 7-1/2% debentures directly to the exchange agent for delivery to the shareholders and pay the cash portion of the offer itself; or, alternatively, Schenley would buy the debentures and cause them to be delivered, with its own cash, directly to minority shareholders. The text of the Proxy Statement did not even mention the existence of these two alternatives; nor did it mention which of the two alternatives would be used. The pro-forma balance sheets in the Proxy Statement, as stated above, indicated that Glen Alden would advance the $16 937,000 of cash and did not even hint that Schenley would purchase the Debentures from Glen Alden.

As we have pointed out above, a reasonable reading of the proxy statement indicated a transfer of no more than $47 million to Glen Alden in the merger. Yet appellees knew that considerably more would be paid to Glen Alden.*

If there was uncertainty, as appellees claimed below--as to the precise amounts of cash to be given to Glen Alden, the Proxy Statement could have avoided committing Schenley to pay out any particular sum without being either delphic or misleading on the subject. It could have been disclosed in its text that Schenley intended to pay out $81 million in cash to Glen Alden for its debentures. And it could have essayed a range of possibilities for payment of cash on appraisal claims, the only real basis for uncertainty. Its failure to do so is not difficult to fathom. When pressed to quantify the reference to "substantial funds," defendants' counsel, (who authored the Proxy Statement), said: "Clearly, then, any shareholder, even one who did not read the proxy statement carefully, would conclude that Schenley was to transfer in excess of $47 million to Glen Alden and perhaps as much as $120 million.

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* Schenley knew as early as March 1971 that it would purchase the Debentures from Glen Alden for $81.3 million (A 1436-7; 689-695), and "provide" the $17 million in cash that was "exchanged" for the minority's shares (U.F.28). Moreover, Riklis expected and had good reason to believe that a great deal more of the surplus cash would be freed up for Glen Alden's use. (A 234-35; 295-96)

This range is more than sufficient disclosure." Defendants' Post Trial Memo, p. 23. It is only "sufficient disclosure" if the purpose is to conceal the magnitude of the funds to be transferred to Glen Alden. The inadequacy of a disclosure involving a swing of $73 million on a base of $120 million needs no elaborate argument, particularly where the purpose for which the law requires such disclosure is to enable the reader to determine approximately how much cash was surplus and was going to be appropriated by Glen Alden.

Third: Schenley's management hardly fulfilled its duty to inform the stockholders of the choice before them by making a passing allusion to the transfer of "substantial funds". Instruction as to management's duty in this regard may be gleaned from General Host Corp. v. Triumph American, Inc. 359 F. Supp. 749 (S.D.N.Y. 1973) which involved an arms length takeover attempt (in contrast to this parent-compelled merger) of a company which was attractive because of the "use of approximately $100 million of gearing that comes with the company." Id. at p. 754. If in that case, the tender solicitor's practice of using its targets' cash to help bootstrap its acquisitions of them was required to be disclosed, the use of Schenley's surplus cash for Glen Alden's benefit was certainly required to be disclosed to its minority stockholders. Failure to do so is

a failure "to meet its burden of fully, frankly and honestly revealing . . . sufficient information from which prospective tenderors might draw their own conclusions. . . . Id. at 755.

The failure to reflect the magnitude of the cash transfer to Glen Alden in the proxy materials is particularly egregious in view of the resulting "dual treatment" given to the inside and outside holders of Schenley common stock. Not only is there a failure thus to reveal "the unique benefits" given to the parent (Kohn, supra at 265) but precisely because there is such dual treatment, its existence must be pointed out and explained. Indeed here (where the public minority stockholders are receiving the parent's subordinated bonds and the parent is taking the assets, including the cash) as in a merger in which the dominant shareholder is receiving cash and the minority shareholders are receiving stock in the acquiring company, the duality of the treatment is of particular concern to the minority. "Certainly, any facts or circumstances which relate to these different modes of payment are likely to be considered important to someone assessing the proposed merger." It was, therefore, "incumbent upon . . . [Schenley's management] to disclose fully and accurately those differences and matters relating thereto so the shareholders could ascertain for themselves the fairness of and the reasons for the merger terms." (Gould v. American Hawaiian Steamship Co., supra 331 F. Supp. at 987. In this case, where disclosure of the dual treatment is less than in the Gould case, the failure of management to explain the "unique benefits" to Glen Alden, or the basis for dual treatment of Schenley's parent and its public stockholders, is even less tolerable than in Gould or Kohn.

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5. The Materiality of the Omitted Information.

The cases uniformly teach the materiality of the facts indicating the growth of Schenley's cash without sacrifice of earnings, the magnitude of its surplus cash (or of the surplus cash that its management knew existed) and the appropriation thereof by Glen Alden for its own corporate purposes while issuing its own subordinated debentures to Schenley's public stockholders in lieu of their share of the surplus cash. While the case law suggests a variety of thresholds of materiality in differing contexts (see pages 27-31, surpra; cf. Gamble Skogmo, supra at 1302; Kohn supra at 269); and General Time Corp. v. Talley Industries, Inc. 403 F.2d 159, 162 (2d Cir. 1968) even the most rigorous test of materiality requires those facts to have been disclosed.

In the language of TSC Industries v. Northway, ___U.S. ____ 98 S. Ct. 2126, 48 L. Ed. 757, 766 (1976), "an omitted fact is material if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote. . . [or] that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available." Where, as here, the facts to be disclosed affect so substantially the adequacy of the price the minority is forced to accept from insiders who have a duty to deal fairly with them, "any omission or misstatement of fact which would affect the offering price must be material under the Northway test. Anything which would affect the price upward or downward would necessarily be important to

the shareholder in making" his decision whether to seek appraisal or to attempt to challenge the fairness of the merger. SEC v. Parklane Hosiery Co. Inc. 422 F. Supp. 477, 485, (S.D.N.Y. 1976).

We have pointed out the well-recognized significance of surplus cash in valuing a prosperous industrial enterprise like Schenley (supra p.37-38). No less than the "surplus - surplus" in the Feit case, the surplus cash in our case is of the essence of materiality to the choice faced by the Schenley public stockholders - as was explicitly recognized by Glen Alden and its experts in deciding to acquire Schenley at the $58.80 per share. And it was no less immaterial to Schenley's stockholders to know of the effect of that cash in conferring "the unique benefits" Glen Alden was receiving in the merger (Kohn, supra at 458 F.2d at 265 and Galfand, supra at 813) or the "dual treatment" being accorded Schenley's outside and inside stockholders (Gould, supra 331 F. Supp. at 987). Certainly, knowledge of those facts would have "significantly altered the 'total mix' of information made available" to Schenley's stockholders.

The fact that Glen Alden's holding of 84% of Schenley's voting power made the minority stockholders' votes impotent does not alter either the threshold of materiality or the scope of the duty to disclose. Cf. Swanson v. American Consumers Industries, Inc., 415 F.2d 1326, 1331 (7th Cir. 1969); Swanson v. American Consumer Industries, Inc., 475 F.2d 516, 520-521 (7th Cir. 1973).

II

The Trial Court Erred In Dismissing the Common Law Claims

Count II of the complaint, based on diversity of citizenship under 28 U.S.C.A. § 1332(a)(1), and Count III, based on pendent jurisdiction, assert the common law claims, as amended by the pre-trial order, wherein Glen Alden, the controlling stockholder of Schenley, and the latter's directors are charged with disregarding their fiduciary duties by (a) forcing the minority stockholders to sell their shares to Schenley at a grossly inadequate price, and (b) using $98.1 million of Schenley's funds to purchase the shares.

The Court below stated at page 11 of its opinion that Count II "was withdrawn upon the trial". Cole and Zisook, the plaintiffs named in Count II, did not withdraw that Count before, during, or after the trial. On the second day of trial, the Court orally dismissed the common claims predicated on unfair merger terms set forth in Counts II and III of the Complaint (A 50-52, 54-66) on several erroneous grounds. First, the Court relied on the decision by Judge Lasker in Voege v. Smith, 329 F.Supp. 180 (S.D.N.Y. 1971), one of the actions consolidated herewith, and the decision by Chancellor Marvel in the Delaware Chancery Court,

Greene v. Schenley Industries, Inc., 281 A.2d 30 (1971), as being decisions in which the fairness of the merger at bar was "fully litigated" and "established" (A 370-71). In his earlier reference to those decisions, the Court said "it is inappropriate . . . as a matter of discretion to relitigate the fairness issue as a fairness issue" (A 348).

Judge Owen said he relied on those decisions,

> "...in part, but in further part on the fact that there has been a hearing on value in Delaware, which is now on appeal, and the difference between $29 and the $30- something [$33.86] is not, in my judgment such as to raise a question of fairness. It is to raise a difference of opinion as to value, which is what Chancellor Marvel points out.
>
> He says that if it's only a dispute in value...then an appraisal is sufficient. I haven't heard anything to the contrary."* (A 254-55)

The "hearing on value in Delaware" was the appraisal proceeding in Gibbons, et al. v. Schenley Industries, Inc., 339 A.2d 460 (1975) in which the appeal was withdrawn.

In Gibbons, the appraiser fixed the $43.87 as the value for the Schenley common and 10% less for the Preferred, (see p. 463) compared to the $29 and $26.10 price offered in

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* Plaintiffs had argued that appraisal was not the exclusive remedy in Delaware where the terms of the merger are palpably unfair and where there is a lack of good faith by the parent in fixing unfair terms in a merger with its subsidiary, as Chancellor Marvel summarized the Delaware law on this point in Greene v. Schenley Industries, Inc., 281 A.2d 30, 35, (1971) (A 336; [illegible]-48)

the merger. Chancellor Marvel reversed the appraiser and decided the fair value of the common stock was $33.86 per share and 10% less for the Preferred. (Gibbons at p.467, 474) In so doing, he also reversed his earlier opinion in Greene, supra, 281A 2d. at 34, that "market price...is...the most significant element to be taken into consideration in reaching a judgment on the overall fairness of a corporate merger" and he had seen nothing in the earnings "past or projected" to shake his reliance on current market prices as the controlling measure of value. In Gibbons, Chancellor Marvel upped the fair value by $4.86 per share by giving weight to Schenley's past and future earnings (339 A. 2 at 474).

In its reliance on Gibbons, the Court below erred in several respects. First, Gibbons did not find the merger terms to be fair. Chancellor Marvel's findings in Gibbons that the common was worth $33.86 or about 17% more than was paid in the 1971 merger is a clear indication that the $29 price was not fair. Secondly, the plaintiff class in Cole with 16,000 members (Consolidated Complaint ¶1(c)(i)) holding about 3,300,000 Schenley shares were not parties to Gibbons. Gibbons was not a class action*, and the plaintiff class had no notice that they would be bound by the proceedings in Gibbons. Under those circumstances, the plaintiff class in Cole was not precluded by the doctrine of res judicata or collateral

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* At Feb. 28, 1973 it was estimated that the maximum number of shares which may be entitled to appraisal was approximately 67,500 shares of common stock and 178,500 shares of the Preferred. (A 1395)

estoppel from asserting state law claims based on diversity or pendent jurisdiction. Hansberry v. Lee, 311 U.S. 32 (1940); Blonder-Tongue Laboratories, Inc. v. University of Illinois Foundation, 402 U.S. 313, 329 (1971).

Finally, it cannot properly be said that the difference between the $33.86 per common share and the $29.00 price "is not in my judgment such as to raise a question of fairness" (A 374). Even if the $33.86 per share represented the fair value of those shares, which plaintiffs dispute, then the plaintiff class was deprived of $4.86 per share or a total of about $15,000,000 to the gain of Schenley and Glen Alden. A gain of such dimension by a fiduciary is outlawed under Delaware law, as it would be in any other jurisdiction. In such a case, appraisal is not the exclusive remedy. Greene v. Dunhill, 249 A.2d 427 (1968); Bruce v. E. L. Bruce, 40 Del. Ch. 80, 174 A.2d 29; and Greene, supra, 281 A.2d at 33, 35-36. However fluid the evolving Delaware law on the subject may be (Ernest L. Folk III, The Delaware General Corporation Law, A Commentary and Analysis ((1972)), pp. 333-337, 395, 397), there was no basis for dismissing Count II, the state law claim based on diversity jurisdiction; or Count III, the pendent claim for a failure to show that the terms of the merger were "so grossly unfair to the minority stockholders of Schenley to the undeserved gain of Glen Alden", as alleged in paragraph 43 of the complaint.

The reliance "in part" on Greene, supra, and Voege, supra, was also misplaced. It is well established that an application for a temporary injunction does not call upon the court to decide the merits of the case and that

the grant or denial of a temporary injunction does not preclude the parties in later trying the merits of the case. "An application for an interlocutory injunction does not involve a final determination of the merits . . ." Public Service Commission of Wisconsin v. Wisconsin Telephone Company, 289 U.S. 67, 70 (1933); Hamilton Watch Company v. Benrus Watch Company, 206 F.2d 738, 742 (2d Cir., 1953); Gulf & Western Industries, Inc. v. Great A & P Tea Company, Inc., 476 F.2d 687, 693 (2d Cir. 1973); Benson Hotel Corp. v. Woods, 168 F.2d 694, 697 (8th Cir. 1948).

The Greene case in the Delaware Chancery Court was discontinued by consent of the parties before reaching the merits. The claim in Voege, based on pendent jurisdiction, that the terms of the merger were unfair, was included as Count III of the consolidated complaint in Cole and was dismissed by the Court below.

It is clear that the basis for the dismissal of Counts II and III was the trial court's erroneous view that Gibbons, Greene and Voege were binding decisions that the terms of the merger were fair.

It is equally clear that the foregoing basis, rather than any actual consideration of the criteria which a trial court should weigh in exercising its discretion to assume or decline pendent jurisdiction, accounts for the decision of the Court below that "fairness as a pendent claim" was not properly before it. (A 328-338, 340-348, 370-374)

The doctrine of pendent jurisdiction, as enunciated in United Mine Workers v. Gibbs, 383 U.S. 715 (1966) would require a court in the circumstances of this case to exercise pendent jurisdiction. The existence and the amount of Schenley's surplus cash and management's attribution of a higher value to the Schenley shares was at the core of the disclosure case as well as the common law claims of unfair terms. Both are closely interconnected and certainly have a common nucleus of facts. A state court is no better equipped or situated to determine these questions of value than a federal court, nor would a state court provide "a surer-footed reading of applicable law." Gibbs, supra at 726. As the Supreme Court stated in Hagans v. Lavine, 415 U.S. 528 (1974):

> "First, it is evident from Gibbs that pendent state law claims are not always, or even almost always, to be dismissed and not adjudicated. On the contrary, given advantages of economy and convenience and no unfairness to litigants, Gibbs contemplates adjudication of these claims." Id. at 545-546.

Here, the parties expended considerable time and effort in extended discovery proceedings and other pre-trial proceedings in preparation for the trial of the state law claims as well as the federal claims, as the pre-trial orders* amply demonstrate.

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* The pre-trial order entered on October 9, 1975, five days before the trial was to start, provided that the first order of proof would be the claims of liability to be followed by proof of damages. The pre-trial order of February 10, 1975 detailed those common claims at pages 78-83 and listed the exhibits at pp. 96 to 103, many of which were to be offered to support the common law claims. (A 112-124, 127-130).

The federal claims were substantial enough to warrant a seven-day trial. It can fairly be said that plaintiff's federal and state claims were "such that he would ordinarily be expected to try them all in one judicial proceeding . . . ." Gibbs, supra, 383 U.S. at 725.

Gibbs instructs that in exercising its discretion on the question of assuming pendent jurisdiction, the trial courts should look to "considerations of judicial economy, convenience and fairness to litigants." Gibbs at 726. This action is an even more compelling case for the exercise of pendent jurisdiction than was Hirsch v. DuPont, 396 F.Supp. 1214 (S.D.N.Y. 1975). In Hirsch the Court retained plaintiff's state law claims of fraud and breach of fiduciary duty even though the federal claims upon which jurisdiction was predicated succumbed to defendant's motion for summary judgment. There, the Court stated:

> "The paramount fact underlying this conclusion is that the case has been pending for three years, and this is literally the eve of trial. Seventeen witnesses have been deposed; their testimony covers 2,850 pages. Over 450 exhibits were marked during the depositions, and thousands of others were examined. To dismiss plaintiffs' state law claims and require them to bring a separate action would be to waste the prodigious efforts of counsel in preparing for trial on these claims. This I am unwilling to do." Id. at 1229-1230 (Footnote omitted)

If the trial court was correct here in its conclusion that the existence and amount of Schenley's surplus cash was fully disclosed as a material fact, then it would follow that the $29.00 value the insiders attributed to the Schenley common was grossly inadequate and rendered the merger terms unfair by a wider margin than was found to be the case in Gibbons.

CONCLUSION

In 1968, Glen Alden made a tender offer for all the then outstanding Schenley common stock at a price of approximately $60 per share. If Glen Alden did not then intend to force a later sale of the minority's shares to it, then the offerees (like the members of plaintiffs' class) were free to refrain from tendering, and to take their chances with the future of Schenley under Glen Alden's management. Having done so, they were entitled at the time of the forced merger in 1971 to the benefits of having remained Schenley stockholders. The merger forced upon them in 1971 denied them the benefits of having been Glen Alden's partners for three years, because they were forced to accept $29 per share, although, as the record shows, and Glen Alden recognized, Schenley was not worth less, but indeed was worth more in 1971. By then, Schenley realized the surplus cash that had been anticipated in 1968 when Glen Alden had been willing to pay about $60 per share for <u>all</u> Schenley shares held by the public. In the circumstances, some explanation was owed to Schenley's stockholders as to why they were forced to take less, let alone so much less, in 1971 than they had been offered in 1968, and whether there was any reason to believe they might be entitled to more. No such explanation was given in the Proxy Statement.

The Proxy Statement was fatally flawed by omissions and obscurities. It failed to reveal the magnitude of the $140

million or more of surplus cash which Schenley had generated between 1968 and 1971 while maintaining its earning power. Such information was essential if stockholders were to have a basis for deciding that the market price (and merger price) forced upon them in the merger was enough less than the real value of the stock to justify incurring the expense of appraisal. Defendants compounded their sin of omission by concealing available information as to the possible disparity between the real value of the stock and its market price--they obscured their own belief in the higher value of Schenley stock by burying statements in notes to the balance sheet and made it difficult, if not impossible, forthe stockholders to understand the disparity in the treatment between inside and outside common stockholders of Schenley--both in the quality of the proceeds being distributed and in the amounts being distributed.

If each set of shortcomings was not itself enough, the cumulative effect of the proxy materials conceals or obscures from the stockholders information which they needed in order intelligently to choose whether to seek appraisal--notwithstanding that Schenley's and Glen Alden's ability to provide such information plainly was demonstrated in other solicitations to stockholders when it suited Glen Alden's needs to do so. That such a choice might have been exercised by public stockholders if the appropriate information had been furnished to them is most eloquently attested by the fact that the leader in seeking appraisal was Lewis Rosenstein who, as a result of that appraisal received

considerably more than Schenley offered in the merger. Significantly Rosensteil knew from his past association with Schenley what the proxy material failed to tell Schenley public stockholders--the hidden values embodied in Schenley's stock. Schenley's public stockholders were entitled to candor and clarity from their management as to those values. They received neither.

As we have shown, the court below erred in utilizing erroneous legal standards in testing the adequacy of the disclosure relating to the fair value of the Schenley shares. It also erred as a matter of law in concluding that previous court decisions involving the merger had established the fairness of the terms thereby precluding it from relitigating that issue. Those errors were compounded by its failure to consider and apply the prescribed criteria by which its discretion was to be exercised in assuming or declining pendent jurisdiction. Those errors of law deprived the holders of approximately 3,300,000 Schenley shares of their right to a trial on the fairness of a merger which forced them to accept so much less than the fair value of their shares.

Relief Requested

Accordingly, it is respectfully requested that this Court reverse the findings of the court below and find that Glen Alden and Schenley violated Sections 14(a) and 10(b) of the Securities Exchange Act by failing to provide material information in the Proxy Statement; that judgment against those defendants on the issue of liability be entered in favor of the

plaintiffs' class and that the case be remanded to the District Court for the determination of damages. Should the Court conclude that defendants did not violate the federal securities laws, then it is respectfully requested that the Court reverse the dismissal of the common claims and remand those claims for trial.

Respectfully submitted

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UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

DOROTHY L. COLE, LOIS H. ZISOOK, HARRY W. VOEGE and ANNA MAY TUNMORE, as Trustees, SAMUEL GREENFIELD FUND, INC., and HAROLD STILLER and MILDRED STILLER, as joint tenants,

Plaintiffs,

-against-

SCHENLEY INDUSTRIES, INC., GLEN ALDEN CORPORATION, RAPID-AMERICAN CORPORATION, ISIDORE A. BECKER, BERNARD GOLDBERG, PAUL A. JOHNSTON, DAVID A. CHERNOW, WALTER O. HEINZE, HOWARD FELDMAN, MILO B. HOPKINS, RUSSELL G. SMITH, ALBERT N. GREENFIELD, MESHULAM RIKLIS, GLEN ALDEN SUBSIDIARY, INC., P.J. CLIFFORD, W.P. JOHNSON, S. KITTAY, M.L. MENDELL, L.C. LANE, G.H. PERKINS and B.DENMARK,

Defendants.

71 Civ. 1028
71 Civ. 1042
71 Civ. 1284
71 Civ. 1536
71 Civ. 2605

OPINION

OWEN, District Judge

This is an action brought on behalf of former shareholders of Schenley Industries, Inc. ("Schenley") with respect to the merger of June 17, 1971 whereby Schenley became a wholly owned subsidiary of Glen Alden Corporation ("Glen Alden"). The main attack of the plaintiffs is upon the proxy statement of May 21, 1971, issued in connection with the upcoming merger, which is alleged to have been materially false and misleading.

The plaintiffs' case basically is founded upon a single fact nucleus, to wit, that Schenley possessed large amounts of what plaintiffs would define and would require management to define as "surplus" or "excess" cash; that this "information" (or "definition") was of importance to the shareholders and that the proxy statement failed to make adequate disclosure about such "excess" cash.

There is no question that Schenley was a "cash rich company" at the time of the proxy statement. The facts about its cash position and the sources of the growth of Schenley's cash were adequately disclosed and are not in dispute. What is in dispute is (1) whether or not the proxy statement wrongfully failed to compare Schenley's cash position on May 31, 1971 with its cash position exactly three years earlier; (2) whether the proxy statement wrongfully failed to disclose the extent of the proposed use of Schenley's cash upon consummation of the merger, and (3) whether the proxy statement wrongfully failed to state that Schenley had approximately $140,000,000 in "excess cash." What plaintiffs' claim comes down to in the final analysis is whether or not Schenley was required to characterize certain facts in a particular way, notwithstanding that they were otherwise essentially disclosed in the proxy statement.

At all times herein involved, Schenley was in the primary business of manufacturing, importing and selling distilled spirits. Until the time of the merger the common and $1.40 preferred stock of Schenley were listed and traded on the New York Stock Exchange.

Starting some time in 1967, Glen Alden was involved in a bidding contest for control of Schenley. In March 1968 Glen Alden purchased 18% of Schenley's common stock from Lewis S. Rosensteil, the founder and chairman of the board of Schenley. Subsequently, in August 1968, Glen Alden made an exchange offer to all stockholders of Schenley. As a result of this offer, Glen Alden became the holder of approximately 88% of the common stock of Schenley.

Since 1964 Schenley had owned 52.7% of the stock of the Buckingham Corporation ("Buckingham") whose sole business was the importation and sale of Cutty Sark scotch whiskey. As a result of the merger in 1969, Schenley became the owner of all of the stock of Buckingham. Former stockholders of Buckingham received $1.40 preferred stock of Schenley which was convertible into 9/10 of a share of Schenley common stock. These preferred stockholders make up approximately 2/3 of the plaintiff class in this action.

As a result of a consent decree in an antitrust

action, Schenley was compelled to divest itself of Buckingham. In October 1970 Schenley announced the proposed sale of Buckingham to Northwest Industries for approximately $120,000,000. The sale was effectuated in May 1971.

On February 25, 1971, Glen Alden announced the terms of the proposed merger with Schenley, to wit, $5 in cash and a $30 face amount 7 1/2% debenture for each share of Schenley common stock, and $4.50 in cash and a $27 face amount 7 1/2% debenture for each share of preferred. Glen Alden had, and announced that it had, sufficient voting power to ensure the consummation of the merger. This package, it is undisputed, had a fair market value of $29 per share for common stock and $26.10 for preferred. This consideration represented a price in excess of the market price of Schenley stock for almost two years (and higher than the market price at any point for ten years except during the bidding contest for control of Schenley) and greater than the market price of Buckingham for over five years.

Several lawsuits were thereupon commenced by stockholders attacking the merger. Three applications were made to enjoin the merger; two by the plaintiffs (Voege and Zisook) in the instant action and one in the Chancery Court of Delaware. All three applications were denied.

Subsequent to the consummation of the merger, statutory appraisal proceedings were commenced in the Chancery Court, and a decision rendered in May 1975.[1]

While there was a dispute arising on the trial as to whether Schenley's cash position[2] at the time of the proxy statement was $162,000,000, as contended by Schenley, or $191,000,000, as contended by plaintiffs,[3] the sources of the improvement in the company's cash position was fully revealed. These sources were the sale of Buckingham, an increase in net worth resulting from operating earnings after the payment of dividends, certain cash held by Buckingham prior to the time it became a wholly owned subsidiary of Schenley's, and the

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[1] Gibbons v. Schenley, Civ. No. 3746. I note that the claimants in Gibbons, as did the plaintiffs here, placed particular emphasis upon the so-called "asset value" of Schenley. The Court, however, refused to give any weight to "asset value," noting,

> "[t]he investing and trading public, in reaching a judgment as to the value of corporate shares, gives consideration to corporate assets only insofar as they disclose a capability of generating earnings, a judgment exercised here. . . ."

The Court also cited Graham, Dodd, Cottle & Tatham, Securities Analysis, p. 519 for the proposition that cash assets bring in little or no earnings.

[2] The term "cash position" here includes cash, certificates of deposit and marketable securities.

[3] The difference is not of consequence to the determination herein and appears to be based upon the use by plaintiffs of a post proxy unaudited balance sheet which does not contain such offsets as amounts for tax liability or required debt repayment.

reduction of inventory.

Plaintiffs' next claim is that there should have been a three year comparison of Schenley's cash position rather than the two year comparison required by the rules of the SEC. The law does not require this so long as the disclosure is otherwise adequate, which here it was. Corenco v. Schiavone Sons, Inc., CCH Fed, Sec.L. Rep. § 94,220 (S.D.N.Y. 1973). The proxy statement fully reveals that Schenley had substantial cash, that the sale of Buckingham was the major source of its "cash rich" position, that its net worth had increased over several years, that its inventories had been reduced, and that Schenley had complete control over the cash previously owned by Buckingham.

Plaintiffs next contention is that there was an inadequate disclosure of the amounts of money that was to be transferred by Schenley to Glen Alden upon consummation of the reorganization. Keeping in mind that Schenley's net from the Buckingham sale was approximately $114,000,000, and that in connection with the merger, Schenley would purchase from Glen Alden the debentures to be issued to the minority shareholders accepting the merger, I conclude that the proxy language that Schenley would transfer to Glen Alden "a substantial portion of

the proceeds" of the Buckingham sale, adequately met the need to advise a reader of the proxy statement of the considerable funds that would be transferred. The exact amount, obviously, was uncertain. An unknown number of shareholders would surely reject the proposal and seek appraisal, leaving Schenley unsure beforehand whether the amount would be $81,000,000 or $61,000,000 or, as it turned out as of the time of trial, some having withdrawn from the appraisal proceedings, $75,000,000. There is no question that a reader of the proxy statement knew that debentures would be purchased from Glen Alden for issuance to minority shareholders. The purchase price and the total number of such shareholders were fully disclosed, setting an outside limit. Indeed, plaintiffs' claim on the trial of inadequate disclosure and doubts as to just how large the transfer would be is undercut by statements these very plaintiffs or their representatives made in seeking to enjoin the merger, at which time plaintiffs concluded that even more money was to be transferred than was in fact transferred.[4] Plaintiffs' reliance on Feit v. Leasco, 332 F. Supp. 544 (E.D.N.Y. 1971) is, in my opinion, misplaced.

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[4] Various of plaintiffs' representatives asserted sums variously estimated as $155,000,000 up to $200,000,000.

There the court stated in the opening paragraph of its lengthy opinion:

> Defendants' registration statement was, we find, misleading in a material way. While disclosing masses of facts and figures, it failed to reveal one critical consideration that weighed heavily with those responsible for the issue -- the substantial possibility of being able to gain control of some hundred million dollars of assets not required for operating the business being acquired.

Without having to discuss the fact that Feit involved an insurance company and the unique problems there involved with the lack of the company's ability to use in any way what is defined in the insurance field as "surplus surplus," funds distinguishable from a business corporation's use of any of its assets, it is clear from Feit that there was no disclosure of the existance of unusable cash constituting "surplus surplus," whereas in the instant case, it is perfectly apparent from the proxy statement that a major independent self-sustaining asset of Schenley's (the Buckingham distilling operation) had been sold, and the proceeds now existed in cash, subject to any appropriate use management might have for it. These facts were fully disclosed.

Next, plaintiffs contend that some sum should have been denominated "excess cash," being that which plaintiffs would define as that cash not needed in the

day-to-day operation of Schenley. Again, however, this is merely a question of definition, for it is perfectly clear from the proxy statement that by proposing to transfer money out of the corporation, that determination had been made by management and was being communicated in the proxy statement. What need, therefore, to give that the label the plaintiffs are here demanding? Further, plaintiffs own expert agreed that the word "excess" was merely a label in acknowledging that he would not apply the word "excess" to any sums, regardless of their proposed use, which management, in good faith, felt was necessary in the overall business of a company.

This case is not to be decided upon a choice of words, so long as the facts themselves are adequately stated for the reader to see. Abramson v. Nytronics, Inc., 312 F.Supp. 519 (S.D.N.Y. 1970).

Finally, plaintiffs argue that Marshel v. AFW Fabrics, 533 F.2d 1277 (2d Cir. 1976), and Green v. Sante Fe Industries, Inc., 533 F.2d 1283 (2d Cir. 1976), cert. granted, 45 U.S.L.W. 3249 (U.S. Oct. 5, 1976), decided subsequent to the taking of testimony herein require a determination in their favor. I find plaintiffs' position to be without merit. Unlike Marshel (which arose on an application for a preliminary injunction), the instant situation was hardly a scheme by Glen Alden

"having previously taken advantage of public financing to appropriate for [its] benefit the entire stock ownership . . . ." In addition, the shareholders in the instant case, unlike Marshel, had an opportunity to invest in stock in the combined entity.

Further, Green declares it to be a violation of 10b-5 only when three conditions exist: (1) a lack of notice to shareholders precluding an opportunity for injunctive relief, (2) gross unfairness, and (3) lack of corporate purpose. None of these are present here. Three attempts were made and rejected by various courts (see supra) to enjoin the merger; claims of gross unfairness were rejected by both this Court and the Delaware Chancery Court; and the corporate purpose, i.e.,simplification of corporate structure under changing business and credit conditions, was established on this record. Plaintiffs' attack based upon Marshel and Green is rejected.

A final minor attack herein is as follows: by an agreement in March 1968, Glen Alden acquired certain shares of Schenley common stock from Louis N. Rosensteil and others. The purchase price was $3.33-1/3 per share in an arm's length transaction. In order to avoid possible future litigation, arguably involving the claim that this was a sale solely for control by insiders, the

agreement also provided that it was the intention of the parties that the other holders of Schenley common would be afforded an opportunity to sell their shares for a total consideration comparable to or more favorable than that paid to the Rosensteil group. Certain plaintiffs herein contend that this established a third party beneficiary claim on behalf of all other stockholders which was still viable at the time of the merger over three years later. Judge Lasker, presented with the same facts, denied a preliminary injunction, pointing out that whatever validity the plaintiffs' arguments might have had at an earlier time, with the passage of time there had been "substantial changes in the business affairs of Schenley since those days." Obviously, no shareholder had a vested right to the same consideration as Mr. Rosensteil ad infinitum. Nothing new has been presented to me to cause me to view this matter differently. Since the Rosensteil sale, Buckingham was sold and there have been other substantial changes in the business affairs of Schenley.

Given all the foregoing, Count 1 is dismissed for failure of proof, Count 2 was withdrawn upon the trial, Counts 4 and 5 were not pursued upon the trial and are dismissed, and Count 3 is dismissed upon the

law and the facts.

The foregoing constitutes the Court's findings of fact and conclusions of law.

Submit judgment on reasonable notice.

November 23, 1976.

United States District Judge

EXCERPTS FROM AUTHORITIES CITED AT PAGE 38 OF THE TEXT:

"In certain cases in which the business as a whole is being valued, a combined capitalized earnings and asset approach may be appropriate. The appraiser may find after valuing the shares on this basis of the earning power of this business that the concern owns certain assets which may be sold or distributed to security holders without impairing the earning capacity of the company. Unneeded cash, Government securities, or unused plant may fall in this category. These 'extra' assets may properly be valued without reference to the earning power of the business and their net realization value added to the capitalized earning value in the final determination of the worth of the stock. This is known as the redundant asset*method." P. Hunt, C. Williams, G. Donaldson, Basic Business Finance Text and Cases, p. 556 (Fourth Ed. 1971).

"An exception is found in redundant assets - that is, assets not required in the operations from which earning power is derived. Since past operating earnings have been produced without their aid, such assets should be treated as an extra contribution. Sometimes they are liquidated, and the proceeds are added to the allotment of securities for the contributing corporation. When the superfluous asset is cash over and above a normal balance, the consolidation might allot bonds or preferred stock rather than issue such securities later to obtain equivalent funds."
Guthmann and Dougall, Corporate Financial Policy, 567 (4th ed. 1962).

Cash Assets—Special Factor in Valuation. Some companies sell at too low a price because their cash assets are too large. This sounds like a paradox, but a moment's thought will show that the statement can be true. Market price depends chiefly on earnings; cash assets bring in no earnings or very little. A company with nothing but cash in bank could not possibly earn enough to support a market price equal to its cash-asset value.

It has been by no means unusual to find companies that are so rich in cash that they are necessarily poor in earning power as related to book value.

We shall reprint, with its sequel, material given at this point in our 1951 edition (page 490):

Example: As a detailed example we supply figures for F. H. Shattuck (operating the "Schrafft's" chain) comparing them with B/G Foods, which is in the same general field [Table 41-6]. B/G Foods sold in 1950 at 50% above book value, while Shattuck sold 50% below book value. This difference is explained by the much more effective use of capital made by the smaller chain. Its sales per dollar of common capital were nearly 3.8 times those of Shattuck. A good part of this divergence, in turn, may be traced to the huge amount of idle cash assets held by Shattuck. From the stockholder's viewpoint Shattuck's policy makes it impossible to earn a fair return on its capital or to support an average market price equal to book value. From the bargain hunter's viewpoint the situation may be attractive for the very reason the outside stockholder is suffering. For this $9 per share he would be getting $7.70 of free-cash assets and $10.80 of other assets. Hence, even though the earnings on total price are not particularly attractive, those on the noncash portion of the price work out at a very high percentage.[8]

Sequel: Shattuck had a singularly uneventful history for the next seven years, its price fluctuating each year quite narrowly about the 9 level. The earnings and dividends made no progress at all, and the cash assets were drawn down for various capital expenditures. Nonetheless, the stock "came to life" in 1958, and by 1961 it had advanced above 31. In this case the development of speculative interest and a major rise in price coincided with the disappearance of the redundant cash.

Graham, Dodd, Cottle & Tatham, Security Analysis
(4th Ed. 1962, p. 564)

ODELL

AFFIDAVIT OF PERSONAL SERVICE

STATE OF NEW YORK
COUNTY OF RICHMOND ss.:

EDWARD BAILEY being duly sworn, deposes and says, that deponent is not a party to the action, is over 18 years of age and resides at 286 Richmond Avenue, Staten Island, N.Y. 10302. That on the 27 day of April ,1977 at No. 120 Broadway, NYC, 1 Battery Park Plaza, NYC; 645 Fifth Ave., NYC 888 Seventh Ave., NYC and 230 Park Ave., NYC

deponent servied the within Brief upon Fried,Frank,Harris,Shriver,&Jacobson, Esqs.,; Simpson,Thacher & Bartlett, Esqs.,; RUBIN, BAUM, LEVIN, CONSTANT & FRIEDMAN, Esqs.; MILTON N. SEASONWEIN, Esq. and Charles Trymin, Esq.

the Appellees herein, by delivering true copy(ies) thereof to them personally. Deponent knew the person so served to be the person mentioned and described in said papers as the Appellees therein.

Sworn to before me this
27 day of April 1977.

Edward Bailey

WILLIAM BAILEY
Notary Public, State of New York
No. 43-0132945
Qualified in Richmond County
Commission Expires March 30, 1978

ODELL

AFFIDAVIT OF PERSONAL SERVICE

STATE OF NEW YORK
COUNTY OF RICHMOND ss.:

EDWARD BAILEY being duly sworn, deposes and says, that deponent is not a party to the action, is over 18 years of age and resides at 286 Richmond Avenue, Staten Island, N.Y. 10302. That on the 27 day of April ,1977 at No. 122 East 42nd St., NYC 10017

deponent servied the within Brief upon Kass, Goodking, Wechsler & Gerstein, Esqs.

the Appellee herein, by delivering 2 true copy(ies) thereof to t h personally. I eponent knew the person so served to be the person mentioned and described in said papers as the Appellee- therein.

Sworn to before me this
27 day of April 1977

Edward Bailey

WILLIAM BAILEY
Notary Public, State of New York
No. 43-0132945
Qualified in Richmond County
Commission Expires March 30, 1978